Social impact investing research

Department of Social Services for the Prime Minister’s Community Business Partnership

Final Report
23 March 2016
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1. Executive summary

Key findings

The findings of this report are based on desktop research of social impact investing both in Australia and internationally and on a series of stakeholder interviews, listed in Appendix C.

Realised benefits from social impact investment:

► There continues to be limited evidence of realised financial benefits for government, both nationally and internationally, primarily due to the developing nature of the sector and the early stage of many existing social impact investments

► Social impact bonds provide examples of positive performance and savings to government however overall evidence is limited as many instruments are not mature, and reporting is not consistent and may be selectively biased

► Social impact investment funds have played a key role in sector capability development, but there is a lack of systematic evidence of value for money for government due principally to variable reporting approaches

► There is limited evidence on social impact investment by private investors in social enterprise in Australia; the more substantive evidence base in the UK suggests benefits can be realised – although reporting focusses on direct outcomes rather than impact for government

Potential for social impact investment in key government areas:

► Evidence for potential benefit across all government areas examined was identified, but this could only be quantified on the basis of existing evidence at a high level due to variable reporting and the specific nature of programs

► Examples of social impact investing identified were principally aimed at reaching unmet need and developing innovative program delivery

While we found some positive indicators of benefit to the Commonwealth Government in this nascent but rapidly growing sector, the evidence base is still maturing and will require continued monitoring and incorporation of lessons learned to date. There will be benefit from enhancing the evidence base and increasing capability in the sector.

1.1 Introduction

EY was commissioned by the Department of Social Services (DSS) to undertake research on social impact investing for the Prime Minister’s Community Business Partnership (the Partnership). The Partnership is considering opportunities to grow innovative investment in Australia and promote collaborative cross-sector partnerships, and intend to make practical recommendations to the Commonwealth Government on how this can be achieved.

1.1.1 Research objectives and scope of research activities

The objectives for the research were:

► To identify the potential benefit to the Commonwealth Government of different forms of social impact investment (SII) (Section 3)

► To quantify the potential benefits to governments and how these benefits are realised (Section 4)
1.2 Realised benefits from social impact investment

There is growing interest in SII among governments, service providers and investors\(^1,2\). While the potential benefits are well documented, identifying clear empirical evidence is more challenging. A detailed discussion of the evidence available is set out in Section 3.

The following summarises our findings on realised benefits to the Commonwealth Government of different forms of SII identifying how these benefits are realised and providing selected examples.

1.2.1 Government commissioning that uses an SII approach

Government commissioning that uses an SII approach principally comprises social impact bonds (SIBs) and also includes payment by results (PbR) schemes and the investment approach, as implemented in New Zealand and under development in Australia.

For SIBs we found examples of positive performance and savings to government however overall evidence of realised financial benefits for government is limited as most SIBs have only been in operation for 1-2 years, which is insufficient time to measure long term outcomes. There may also be selection bias in public reporting.

It is unclear as to whether PbR and outcomes-based contracting schemes offer value for money overall compared to other mechanisms, as results varied considerably between providers, programs and sectors\(^3\). Available information on the investment approach identified its value segmenting the needs of the jobseeker population and in justifying additional investment for those with greater needs\(^4\).

1.2.2 Increased supply of finance for social sector organisations

We focused on social impact investment funds (SII funds) but also considered Community Development Financial Institutions (CDFIs).

The evidence of overall benefits to government of SII funds is not yet clear. We found multiple examples of positive short term results, but little information on longer term impacts. A key achievement of SII funds has been in capability development in the social enterprise sector\(^5\).

Evaluations of CDFIs have consistently found that they address market failure by assisting disadvantaged individuals and enterprises to access capital\(^6\), CDFIs (including credit unions and microenterprise development funds) have addressed financial exclusion in overseas jurisdictions for several decades but are not common in Australia\(^7\).

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\(^3\) For example, the UK Children’s Centres payment by results trial provided some evidence that it could be successful but would require significant improvements, Frontier Economics & the Colebrooke Centre (2014) Payment by Results in Children’s Centres Evaluation. London: Department for Education

\(^4\) Ministry of Social Development, 2013 and 2014 Benefit System Performance Reports

\(^5\) Foresters Community Finance Annual Review, Foresters, November 2014

\(^6\) Community Development Finance Institutions (CDFIs), A new option for addressing financial exclusion in Australia, Social Ventures Australia, December 2009

\(^7\) See Section 3.2.2 and Section 4.4 for further discussion
1.2.3 Increasing social impact investments undertaken by private investors

There is limited information on the Australian social enterprise sector\(^8\), although research in 2010 estimated that there were 20,000 social enterprises in Australia, with the number increasing by 7% per annum over the previous five years\(^9\). There is a more substantive evidence base for social enterprise in the UK, where they are outperforming small and medium sized enterprises in terms of start-ups, growth in revenue, job creation, innovation, diversity in leadership, and business optimism\(^10\), however this does not directly identify realised benefits to government.

1.2.4 Selected examples

The following table highlights key examples of evidence we found in respect of each of the assessment criteria used to assess the effectiveness and efficiency of SII.

<table>
<thead>
<tr>
<th>Assessment criteria</th>
<th>Selected examples (detailed references can be found in Section 3)</th>
</tr>
</thead>
</table>
| Value for money, contestability and transfer of risks | • Newpin SBB has achieved an investor return of 8.9% p.a. to date (see case study, Section 5.4)  
  • Rikers Island SIB terminated early, avoiding cost to government (see case study, Section 5.3)  
  • Risk transfer occurs, with limits, such as the government standing charge for Newpin and Benevolent Society SSBs  
  • UK Audit Office found PbR schemes hard to design and implement effectively and couldn’t assess value-for-money (see section 3.1.2)  
  • STREAT (see case study, Section 5.2) and SVA, among others, identify positive short term results from SII fund activities, but there is little evidence available to demonstrate long term benefits  
  • SIBs to date assessed as “time-intensive and costly operations”\(^11\) relative to some other models seeking to deliver service programs |
| Stimulate and support innovation | • The UK Work Programme “black box” commissioning approach enabled provider flexibility to adapt service interventions to individuals and local conditions  
  • However the extent of SIBs and SII fund selection criteria suggest these are less well suited to funding high risk pilots of innovations than to scaling up proven programs |
| Scale up services to meet unmet need | • Chronic Individual Homelessness Pay for Success Initiative in Massachusetts is scaling up an existing program: expanding in existing locations and adding new locations  
  • Utah High Quality Preschool SIB expands an innovative preschool program  
  • NSW and Queensland SIBs focus explicitly on government priority areas of unmet need  
  • SEFA, Foresters and SVA funds directed to areas of need including housing, health, disability, education and training and indigenous sector |
| Increase service provider and sector capability and capacity | • Inspiring Scotland and Foresters’ evaluations note key role of SII funds in capability development, especially in outcomes and impact measurement |
| Improve transparency, accountability and performance | • Peterborough, Rikers Island and Newpin SIBs are examples providing detailed public information  
  • Learnings from Peterborough changed policy and funding of rehabilitation services for short term prisoners  
  • Some PbRs enable knowledge sharing, e.g. UK Troubled Families Programme |

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8 This is being explored through the Finding Australia’s Social Enterprise Sector (FASES) research initiative.  
10 The People’s Business, Social Enterprise UK, 2013  
### 1.3 Potential for social impact investment in key government areas

We identified areas where an SII approach might be a valuable tool for governments, particularly the Commonwealth Government, by reviewing government objectives and identifying areas of unmet demand or market failure. Using examples of SII with some evidence for benefits from our desk research we have identified the potential for application of SII to those areas, including high level quantification of potential impact.

We note that there continues to be limited evidence of realised financial benefits for government, both nationally and internationally, primarily due to the developing nature of the sector and the early stage of many existing SIIs. Challenges in translating or adapting realised benefits from international examples to potential applications in Australia meant that we often could not quantify benefits on the basis of existing SII evidence alone beyond a high level indication.

<table>
<thead>
<tr>
<th>Key government area and potential need</th>
<th>Selected examples of SII with potential (or actual) application in Australia (detailed references can be found in Section 3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early education and childcare</td>
<td>• Utah High Quality Preschool SIB expands a preschool program for low income cohorts</td>
</tr>
<tr>
<td>• Unmet need: specific to certain groups</td>
<td>• PbR and SII fund examples which expand scale of providers, particularly those servicing disadvantaged communities include UK Children’s Centres and Germany’s Kinderzentren Kunterbunt</td>
</tr>
<tr>
<td>• Goodstart Early Learning is a key Australian example (see case study, Section 5.1)</td>
<td></td>
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<tr>
<td>Employment, further education and training</td>
<td>• Scaling up demonstrated by UK Department of Work and Programmes Innovation Fund and underlying SIBs, US New Profit Inc Fund and SVA Fund - AIME organisation</td>
</tr>
<tr>
<td>• Unmet need: Youth unemployment and other specific groups with high needs</td>
<td>• Examples of programs focused on youth, often at multiple disadvantage, include debt and equity funds for special needs groups such as SVA – STREAT (see case study, Section 5.2); Beacon Foundation; Social Impact Scotland – Aberdeen Foyer; SVA – PGM Refiners and Ability Enterprises; SEFA – MiHaven; UK Impact Ventures – K10; US National Fund for Workplace Solutions; US REDF and UK Key Fund – Paperworks</td>
</tr>
<tr>
<td>• Innovative program delivery: SII are prominent</td>
<td></td>
</tr>
<tr>
<td>Affordable housing</td>
<td>• SII funds include SEFA – 3 Sista’s; UK Real Lettings Property Fund; UK Homes for Good; UK Golden Lane Housing</td>
</tr>
<tr>
<td>• Unmet need: Increasing demand and need for infrastructure capital</td>
<td>• Housing bonds include Canada’s Toronto Community Housing Corporation Bond; UK Derwentside Homes</td>
</tr>
<tr>
<td>Financial inclusion</td>
<td>• Evaluations of CDFIs in UK, US, Canada and Australia consistently found that CDFIs address market failure and reach unmet need</td>
</tr>
<tr>
<td>• Unmet need: estimated 17% of Australians excluded</td>
<td>• DSS is already exploring the benefits of CDFIs</td>
</tr>
<tr>
<td>Aged care</td>
<td>• Aged care has not been a major focus of SII activity to date</td>
</tr>
<tr>
<td>• Unmet need especially rural and regional areas</td>
<td>• UK PbR: Newquay Pathfinder for Integrated Care is one example</td>
</tr>
<tr>
<td>• Innovative program delivery as consumer directed care (CDC) is implemented</td>
<td></td>
</tr>
<tr>
<td>Health</td>
<td>• Social Enterprise UK estimates that around a third of its members operate in health and social care</td>
</tr>
<tr>
<td>• Unmet need arises from poor co-ordination of service planning and delivery, pressure of ageing population and in some specific needs groups</td>
<td>• SII fund Big Society Capital UK funds Shared Pathfinder</td>
</tr>
<tr>
<td></td>
<td>• National Health Co-op, ACT, is an Australian example of a co-operative social enterprise reaching unmet need</td>
</tr>
<tr>
<td>Disability services</td>
<td>• SII fund Big Society Capital UK funds the Shared Lives Incubator</td>
</tr>
</tbody>
</table>
1.4 Case studies

We have provided four case studies of varying types to demonstrate particular aspects of SII in an Australian context:

1. Goodstart Early Learning: demonstrating the benefits of financial innovation.
2. STREAT: seeking commercial sustainability through equity social finance.
3. Rikers Island Social Impact Bond: failed program but successful mechanism.

These are detailed in Section 5.
2. Background, scope and assessment criteria

2.1 Background

EY was commissioned by the Department of Social Services (DSS) to undertake research on social impact investing for the Prime Minister’s Community Business Partnership (the Partnership).

The Partnership is considering opportunities to grow innovative investment in Australia and promote collaborative cross-sector partnerships; it intends to make practical recommendations to the Commonwealth Government on how this can be achieved.12

The Organisation for Economic Co-operation and Development (OECD) defines social impact investing (SII) as “the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial, return”13. SII engages a range of stakeholders including:

- Governments as primary agents for commissioning services to address social needs and support other stakeholders that address social needs
- Not-for-profit organisations and social enterprises as providers of these services
- Investors that provide finance for these services and organisations
- Intermediaries that seek to develop and support SII propositions

There are three dominant forms of SII:

1. SII mechanisms which are products of government commissioning of services where a SII approach has been applied. These mechanisms combine the interests and incentives of the key stakeholders listed above. Social impact bonds are the most prominent examples from this category; other examples include payment by results schemes and the investment approach to government services such as welfare and housing.

2. SII funds which supply finance to social sector organisations. These act as intermediaries between social sector organisations and social impact investors (including both government and private sectors).

3. Social enterprises that are created by or utilise SII to provide start-up, growth or operating finance.

Further detail on the definition, forms and participants involved in SII activity is set out in Appendix A.

2.2 Research objectives and scope of research activities

The objectives for the research were:

- To identify the potential benefit to the Commonwealth Government of the following forms of SII (Section 3):
  - Government commissioning that uses a SII approach
  - Increased supply of finance for social sector organisations
  - Increased SIIIs undertaken by private investors

- To quantify the benefits to Governments and how these benefits are realised (Section 4).

- To identify areas where a SII approach might be a valuable tool for Governments to more efficiently and effectively achieve their objectives (Section 4.9).

- To provide a range of case studies that demonstrate examples of successful SIIIs that could be replicated in Australia (Section 5).

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12 Department of Social Services Request for quotation(#70006412) Social impact investing research
2.3 Scope of work and limitations

In conducting our research, we have undertaken the following tasks:

► Formulation of definitions, classification and assessment criteria.
► Desk research to identify the potential benefit to the Commonwealth Government of different forms of social impact investment.
► Desk research and stakeholder engagement to identify where social impact investment might be a valuable tool for governments to more efficiently and effectively achieve their objectives.
► Desk research to quantify the benefits to governments and how these benefits are realised.
► Formulation of potential actions governments can take.
► Formulation of case studies that demonstrate examples of successful social impact investments that can be replicated in Australia.
► Interviews with SII experts and government agencies
► Interaction with the Partnership

We have not sought to verify the accuracy of data or information obtained from publicly available sources or information provided to us by others.

At the instruction of the Partnership, emphasis has been placed on the identified evidence or gap in evidence of measurable benefits of SII (financial, social and economic) that governments in Australia could gain from increased impact investment activity.14

In line with the purpose of the Partnership to provide high level advice to the Commonwealth Government on practical changes, we also considered the actions that governments can take to increase SII activity, acknowledging that the market of investors, investee organisations and intermediaries is the main driver of the development of SII. As stated in the McClure report:

“Governments should work with civil society organisations and business to deliver an effective, efficient and sustainable capital market that better directs financial investment towards social purposes and solving social problems.”15

EY has acted in accordance with the instructions of DSS and the Partnership in conducting its work and preparing the Report, and, in doing so, has prepared the Report for the benefit of DSS and the Partnership, and has considered only the interests of DSS and the Partnership, pursuant to the Official Order 90006942 under the Deed of Standing Offer 46074635. EY has not been engaged to act, and has not acted, as advisor to any other party. Accordingly, EY makes no representations as to the appropriateness, accuracy or completeness of the Report for any other party's purposes.

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14 Department of Social Services Request for quotation (#70006412) Social impact investing research
15 McClure (2015) A new system for better employment and social outcomes
2.4 Assessment criteria

The assessment criteria below were applied to each area of Commonwealth Government responsibility under consideration, in order to assess the relative efficiency and effectiveness of SII for agencies.

► Improve value for money and contestability – SII forms, if they achieve their outcomes, should reduce the demand for Commonwealth Government services and achieve cost savings or avoid costs for government. To be contestable these should be comparable or better than that achievable via other means, such as direct government funding or tax incentives for private organisations. Assessment against this criteria includes a consideration of the potential social and economic impacts and their timing, the expected development and transaction costs involved with creating the SII and the risks associated with the implementation and performance of the SII.

► Risk transfer to investors – effective SII mechanisms transfer appropriate financial risk from Government to investors, and incentivise service providers to operate to achieve outcomes. Service providers bear some financial risk under some arrangements.

► Stimulate and support innovation – effective and efficient SII mechanisms should be able to stimulate and/or support innovation where current government-commissioned services are not delivering desired outcomes and achieving policy goals, where government research and development budgets are limited, and where government is willing to pay for outcomes.

► Scale up services to meet unmet need – an effective and efficient SII arrangement should be able to scale up an effective program operating at a small scale or in another jurisdiction, in order to satisfy unmet needs or achieve better value for money16. This should involve an increase in supply of non-government finance to the service provider or area, rather than crowding out or competing with other funding sources or investments.

► Increase service provider capacity and capability – effective and efficient SII arrangements can facilitate access to non-government sources of working capital for individual service providers to help them increase their service capacity and capability. This could be particularly relevant for providers that are adapting to public service reforms, delivering additional government contracts or participating in payment by outcomes mechanisms.

► Increase sector capacity and capability – effective and efficient SII arrangements can also facilitate innovation and collaboration at a sector level:

► Facilitate collaboration – Government can use SII to facilitate the development of consortia to not only access private finance and share risk but also to facilitate collaboration, encourage innovation, leverage expertise, improve asset utilisation, and provide integrated long term management. This is comparable to government’s use of public-private partnerships (PPPs) for infrastructure where government and PPP proponents are now able to accurately cost the delivery of infrastructure and have a good understanding of risk which means that they are able to price delivery and secure investors.

► Facilitate the development of social enterprises – the activities of some social enterprises are aligned with government policy goals and can be supported by SII. For example, employment services operated by social enterprises generate and sustain jobs, and through the use diversified revenue streams can subsidise jobs and reduce the call on government funds, and may provide better outcomes for key client segments including those finding it difficult to enter the workforce, such as people with a disability17.

► Promoting diversity and capability of service provision - including support for social enterprises and capacity building in social organisations providing government funded services.

16 For example, the first Social Impact Bond at Peterborough scaled up a program originally operated by the St Giles Trust. The St Giles Trust commissioned a Social Return on Investment (SROI) study which was undertaken by ProBono Economics http://www.probonoeconomics.com/news/publications/first-pbe-report-st-giles-trust

Increase transparency, accountability and performance - where effectively implemented, SII measurement and reporting requirements should increase the transparency and accountability of government-funded services. For government, this should enable more effective performance monitoring and thus inform the amendment of policy settings and commissioning parameters. For service providers, this should support an increased focus on outcomes and clients and improve the quality of services provided. Criteria for effective SII include:

- Target cohorts that can clearly be identified for service provision
- Evidence-based program with a clear, measurable and causal link to the outcome being measured
- Outcomes that can be clearly measured over the duration of the investment
- Outcome measures that can be clearly linked to the program objectives
- Outcome measures that can be clearly linked to Commonwealth Government fiscal benefits
3. Review of evidence for social impact investment benefits

This section sets out our assessment of the evidence for realised SII benefits that is publicly available to date, based on the assessment criteria set out in the previous section. It is important to note that the desk research and interviews confirm that there continues to be a lack of evidence of measurable benefits.

3.1 Government commissioning that uses a social impact investment approach

Australian and international governments have explored the use of social impact bonds in government commissioning over the last five years. EY has reviewed these and also considered mechanisms which share characteristics with SII and may link to SII in the future: payment by results (PbR) and payment by outcomes (PbO) schemes and the “investment approach” exemplified by New Zealand’s welfare investment model.

For details on the description and characteristics of social impact bonds, PbO/PbR schemes and the investment approach, refer to Appendix A.

3.1.1 Social impact bonds

<table>
<thead>
<tr>
<th>Assessment criteria</th>
<th>Observations</th>
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| Value for money, contestability and transfer of risks | ▪ For the SIBs that have publicly released performance information to date, early results indicate that many of these are meeting or exceeding their performance targets and are therefore on track to achieve their longer term outcomes including cost savings to government. However, overall evidence of realised financial benefits for government is somewhat limited as most SIBs have only been in operation for 1-2 years and have not yet released results; they have had insufficient time to measure the achievement of outcomes and have therefore not reached the first trigger for reward payments.  
  ▪ Development and implementation of SIBs to date have been assessed as “time-intensive and costly operations” relative to some other models used to deliver similar service programs. The evidence identified did not reveal whether the set up costs incurred by each stakeholder were rolled in to the financial arrangements for each SIB or whether they were written off as a cost for innovation. Most SIBs were tailored to reflect the interests and needs of the different stakeholders and are highly customised and took one to two years to develop and implement; for example, the joint development phase (JDP) of the first round of SIBs in NSW took a year to complete and involved the equivalent of six full-time staff over that time across all stakeholders involved.  
  ▪ The specifications and timetables for more recent Australian SIBs have a shorter timeline for development and implementation - for example the 2016 round in NSW aims for a JDP of six months. The feasibility of this is supported by evidence from the desk review and interviews showing considerable learning across jurisdictions, the re-use of resources developed by proponents and intermediaries, and greater clarity in specifications of what outcomes government is seeking to purchase.  
  ▪ SIBs to date have involved a partial (but not full) transfer of financial risk to investors, with partial but not full risk transfer indicated in some cases through the use of limited partnerships or elsewhere through the use of co-investors or guarantees.  
  ▪ Evaluation of the Joint Development Phase of the NSW Social Benefit Bond Trial, KPMG, January 2014  
<table>
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<tr>
<th>Assessment criteria</th>
<th>Observations</th>
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<tr>
<td></td>
<td>the extent of risk transfer varying by instrument. We observed that governments or private foundations typically limit the downside risk for investors and service providers by providing a guarantee or standing payment so that only a proportion of the payment is dependent on the achievement of outcomes. For example, the NSW government provided a standing charge of approximately 50% of the service delivery costs for the Newpin and Benevolent Society Social Benefit Bonds, and for the earlier US SIB (Rikers Island) Bloomberg Philanthropies guaranteed $7.2m of the original $9.6m loan amount. Typically SIBs also have limits on upside risk and cap reward payments. For example, the return to investors for Newpin is capped at 15% per annum. The effectiveness of SIB risk sharing in relation to downside risk has been evidenced by the termination of the Rikers Island SIB, as it was unable to demonstrate the level of effectiveness expected. The SIB mechanism was effective in promptly identifying and then ending an underperforming program, thus avoiding loss of government funds.</td>
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<td></td>
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<tr>
<td>Stimulate and support innovation</td>
<td>Commentary from government SIB commissioning processes suggests that SIBs have brought stakeholders together in consortia and used an innovative approach to reduce the need for government to fund research and development, and pilot programs.</td>
</tr>
<tr>
<td></td>
<td>There has been limited use of SII to facilitate significant scale up of proven programs. The Chronic Individual Homelessness Pay for Success Initiative in Massachusetts is an example of scaling up a proven program: it is targeting 800 chronic homeless adults and is one of the larger SIBs with USD 25 million. As the program is still in the process of being implemented, it is not yet known whether its benefits will be realised. SIBs tend to focus on government priority areas with significant unmet need where cashable cost savings can be realised over a relatively short timeline (three to five years). This reflects government commissioning processes which identify priority areas for SII proposals (such as reducing justice re-offending, preventing or reducing out-of-home care or homelessness) and a preference for programs where it is more straightforward to design outcome measures and measure performance.</td>
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<tr>
<td>Scale up services to meet unmet need</td>
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<td></td>
<td>This suggests that SIBs have not yet addressed social issues where the desired outcomes can only be measured over the long term; for these programs the contracting process would be more challenging, complex and potentially lengthy. We were unable to determine if these are not addressed because they are less favoured, or less favoured because they are more difficult to design.</td>
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<tr>
<td></td>
<td>SIBS have been successful in leveraging private capital for individual service providers. However the impact on overall sector capacity is not yet significant, as many SIBs are small (with some requiring only a few hundred thousand dollars of capital). This is thought to reflect that SII is a relatively new concept and that government’s current purpose for using SII is to innovate in terms of the financing model and/or the intervention.</td>
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<td></td>
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<tr>
<td>Increase service provider and sector capability and capacity</td>
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### Assessment criteria

<table>
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<tr>
<th>Observations</th>
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<tbody>
<tr>
<td>- Increase transparency, accountability and performance</td>
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<tr>
<td>- The level of public disclosure around performance information varies considerably. Some SIBs (e.g. NSW Newpin SIB(^{31}), UK Peterborough SIB(^{32}), US Rikers Island SIB) provide information on financial and social returns including interim results, effectively sharing their learnings with the sector. Others provided little or no public information on their interim results to date, which has meant we are unable to observe if they are providing additional transparency and accountability.</td>
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<tr>
<td>- Many of the SIBs which have documented their structures and performance to date have been designed so as to provide increased transparency and accountability over their results:</td>
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<tr>
<td>- Most have specific and well-defined purposes and target cohorts that can be translated into measurable outcomes expected to deliver government cost savings.</td>
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<td>- Most are based on programs where there is some evidence of success with delivering longer term impacts and where costs are known (for example, documented theories of change and associated benefit cost analysis).</td>
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<td>- Most have documented performance baselines which will assist with the attribution of outcomes to the program. We note that there is variation in the methods for measuring outcomes and counterfactual.</td>
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<tr>
<td>- For some of the more mature SIBs, reviews of the development phase and operation suggest that they have produced some service improvements:</td>
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<tr>
<td>- The UK Government’s Peterborough prison SIB was closed early as the learnings from its early performance (along with that of payment by results pilots) were considered a sufficient basis for a new policy and funding program under which rehabilitation services are expanded to all short term prisoners(^{33}).</td>
</tr>
<tr>
<td>- The outcome measures for NSW’s Newpin SIB were adjusted partway through the program to reflect learnings from the program to date. In addition, the evaluation report of Newpin’s implementation stated that the SIB program has “created a more structured and transparent basis for action” and “the introduction of greater data capture and reporting is forming a stronger basis for staff reflecting on and improving practice, and adding to the evidence base for future program enhancement”(^{34}).</td>
</tr>
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</table>

In assessing the evidence for SIBs currently available, it is important to note that:

- There may be a positive selection bias associated with the availability of evidence for SIBs to date. The timing and quality of reporting progress and performance varies and it may be that the SIBs which are on track to achieving their targets are providing timely and well documented evidence.

- SIBs have had to meet extensive eligibility criteria (this often includes being able to prove evidence for the effectiveness of the program) and have also passed through an extended selection and joint development phase incorporating government, investors and service providers. This may be considered to be a more selective process than standard government procurement and philanthropic grant mechanisms, and may influence the success rate of SIBs when compared to other government programs and grants.

#### 3.1.2 Payment by results and outcomes based contracts

The evidence we found was mixed as to the effectiveness and efficiency of these programs, with the quality of implementation and differential performance between cohorts emerging as the chief driver of program performance.

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\(^{31}\)Annual Investor report, Newpin Social Benefit Bond, 30 June 2015

\(^{32}\)Lessons learned from the planning and early implementation of the Social Impact Bond at HMP Peterborough, RAND Europe, 2011


\(^{34}\)Evaluation of the Newpin SBB Program – Implementation report, Urbis, September 2014
### Assessment Criteria

<table>
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<tr>
<th>Observation</th>
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<tr>
<td><strong>Value for money, contestability and transfer of risks</strong></td>
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| - It is unclear as to whether PbR and outcomes-based contracting schemes offer value for money overall compared to other mechanisms, as results varied considerably between providers, programs and sectors. Performance appears to be highly dependent on the efficacy of the provider, the target cohorts and the effectiveness of the scheme’s implementation. Given the wide variety of outcomes, some providers were seen to perform well in some areas while underperforming in others.
| - The UK Audit Office reviewed the UK Government’s PbR schemes in June 2015 (with a specific focus on the Work Programme) and concluded that they were hard to design and implement effectively, making them risky and costly for commissioners. It was also unable to assess whether PbR contracts did offer value for money in return for the additional risk and cost, as none of the schemes explicitly set out how value for money would be evaluated.
| - Similarly to SIBs, there are significant time requirements and timeframes associated with the process of developing, administering and refining PbR and outcomes-based contracting schemes (although we note that these can be applied on a state or nationwide scale, unlike SIBs which are program specific).
| - As with SIBs, PbR and outcomes based contracting schemes involve the transfer of some financial risk to service providers (as payment is only made if results are achieved). However, government retains the implementation risk associated with the scheme. The UK Audit Office’s review of PbR schemes indicated that this can be higher than the risk from a standard funding or grant contracting scheme, especially where results measurement is complicated or where service providers have limited capability to measure results.
| **Stimulate and support innovation** |
| - In terms of encouraging innovation, the Work Programme in the UK operated under a “black box” commissioning approach which moved away from detailed specification of service delivery to allow providers greater flexibility to adapt service interventions to individuals and to local conditions.
| - We note that there is a risk that this approach may lead to successful service providers protecting their intellectual property and not sharing learning with other providers. One option could be to address the IP issue in contracts and to establish mechanisms to share best practice.
| **Scale up services to meet unmet need** |
| - The nature of PbR schemes and outcomes based contracts and evidence to date suggests that this approach is being used for services or programs where results can be more easily measured over the contract period (i.e. short term) and attributed to provider interventions.
| - The PbR and outcomes based contracts we examined focus on policy areas where there are clearly identifiable target cohorts for service provision, straightforward short term outcomes or performance measurement, and links between short term and long term outcomes. For example, 13 and 26 week work placements are expected to increase the likelihood of more permanent employment. To date the majority of the examples our research revealed are focussed on specific types of employment, health and education services.
| **Increase service** |
| - There is no evidence found on whether programs increased the capacity and capability of providers and the sector in general. For the PbR schemes in employment services, this does not occur.

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35 For example, the UK Children’s Centres payment by results trial provided some evidence that it could be successful but would require significant improvements. Frontier Economics & the Colebrooke Centre (2014) Payment by Results in Children’s Centres Evaluation. London: Department for Education

36 Outcome - based payment schemes: government’s use of payment by results, National Audit Office, 19 June 2015

37 The Work Programme, UK Department for Work & Pensions, December 2012

38 Contracting for Outcomes, A Value- Based Approach, Outcome Based Health Care, July 2014


40 For example, Tasmania’s Department of Health and Human Services has developed an Outcomes Purchasing Framework for community service providers provides evidence of transitioning existing grants or block contracts to an outcomes based framework across other areas, such as disability services, out-of-home care and child and family services.
provider and sector capability and capacity

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<tr>
<th>Assessment criteria</th>
<th>Observations</th>
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| not appear to be an objective and increasing requirements were observed to sometimes lead to consolidation as well as sharing back office costs and specialist capability. Some evaluations found that, depending on the logistics of the program, smaller providers and/or providers in regional or rural areas with low population densities and tight budgets struggled to meet targets compared to larger and/or metropolitan providers. An example is the US Workforce Investment Act program with their One-Stop Career Centers which struggled to establish regional access points with effective staff who could provide services to a wide range of customers.

- We observe that the need for capability to rigorously measure results and capital to support the transfer of risk from government to provider is likely to result in a skew towards larger, well-established providers. There can also be indirect consequences for smaller service providers, who may have to source alternative sources of funding if not selected by schemes.

- Depending on the payment structure, independent evaluation on certain programs indicated that providers sometimes opted to focus on helping ‘easy to service’ individuals (‘creaming’) over servicing ‘harder to help’ individuals (‘parking’), despite the higher payments attached to achieving outcomes for the latter. This situation was anecdotally said to occur in programs targeting employment; however it was difficult to prove in practice.

Increase transparency, accountability and performance

- Most of the PbR schemes we examined provide increased transparency and accountability around some contract aspects (e.g. target cohorts and outputs) but face implementation challenges in other areas (e.g. outcomes measurement and attribution):
  - Most have clearly identifiable target cohorts, as well as links between short term and long term outcomes.
  - Most have an in-built outcome measurement system which provides the basis for regular reports. However, in practice both service providers and government agencies showed varying levels of understanding around how to identify, define and measure outcomes, leading to issues with collecting data from some providers.
  - Most do not compare results to a counterfactual group, making it difficult to explicitly attribute the success to the program.
  - Some PbR mechanisms use knowledge sharing tools and other initiatives such as annual meetings to share learning which allow measurement problems to be addressed and facilitate continuous improvement.

3.1.3 Investment approach to welfare reform

New Zealand’s investment approach has been in place for four valuation cycles with the methodology and models still under development, so only early information is available on the effectiveness and efficiency of its use to improve welfare outcomes.

We observe, however, that the approach is being used to develop the evidence base for the recent introduction of new welfare services and interventions, and that transparency over performance results is provided through annual reporting. Based on the investment approach, service expenditure continues to focus on increasing investment in employment assistance and providing targeted services to people with high long term social and economic needs, including individualised case management. Introducing

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41 There were over 200 providers of employment services in the early 2000s compared to fewer than 50 under jobactive. Department of Employment, Workplace Relations and Small Business, 2001, Job Network evaluation, Stage two: progress report. Department of Employment, Job Services Australia Provider Performance - Star Ratings
42 UK’s Reducing Reoffending Partnership comprising St Giles Trust, Ingeus and CRI operate probation services in the Midlands http://www.rrpartnership.com/about.php; CoAct is a network of not-for-profit organisations “embedded in the social fabric of their communities” http://www.coact.org.au/members/our-members
43 One-Stop Career Centers Must be Re-invented to Meet Today’s Labor Market Realities, Corporation for a Skilled Workforce, June 2013
45 For example, the jobactive and former Job Services Australia data systems
47 For example, The UK’s troubled Families Programme has an annual meeting http://www.troubledfamiliesconference.com/agenda
a lifetime expected estimate of future welfare outgo has helped in segmenting the needs of the
jobseeker population and in justifying additional investment in those with greater needs.

3.2 Increased supply of finance for social sector organisations

We considered the following forms of finance for social sector organisations:

- SII funds, which provide a pooled investment structure by which government and private investors
can combine their funds to jointly finance a range of social enterprise funds and organisations

- Community Development Financial Institutions (CDFIs), which are similar to SII funds but which can
provide loans to individuals as well as organisations and have a greater tendency to be place-based
(that is, operating within a specific community)

For details on the description and characteristics of each of these forms, refer to Appendix A.

3.2.1 Social impact investment funds

To better understand the effectiveness and efficiency of SII funds to date, we reviewed impact reports
and other sources of information on results from a wide range of SII funds as well as their underlying
social enterprise investments (where this was available).

<table>
<thead>
<tr>
<th>Assessment criteria</th>
<th>Observations</th>
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| Value for money, contestability and transfer of risks | The value-for-money of SII funds is not yet clear enough to conclude on and will depend on the extent to which they can demonstrate longer term social impact emerging from their portfolios. We found evidence of benefits from individual funds and in surveys conducted in other jurisdictions if they were able to systematically report the social and economic impact of their loans. For these funds, we generally observed:
  - Fund investments achieved positive short term results across the majority of key areas, including:
    - Housing48 (development of affordable housing with the majority of clients sustaining their tenancies)
    - Health49 (greater provision of home and/or community care reducing hospital entries)
    - Employment, education and training50, 51 (at-risk clients obtaining or progressing training and qualifications, and/or successfully completing work placements)
    - Early education52 (quality early learning/childcare services delivered to disadvantaged families, sometimes in conjunction with evidence based parenting skills programs)
  - Some of the results achieved so far have been shown by research to have relatively strong links to longer term outcomes, meaning that the expected benefits to government (in the form of reduced expenditure and improved outcomes) are more likely to be realised. For example, experience from several supported housing programs (Australia and overseas) indicates that sustained housing is linked to better health and justice outcomes as well as improved wellbeing and community links53.
  - There was little information on the longer term impacts of fund investments to date (e.g. sustainability of employment over a year or more, ability to maintain private rental tenancies) from which government cost savings emerge. There was also little information on the extent to which social enterprises were able to sustain the expansion in their capacity after the loan ended.
  - We note that this is unsurprising given most of these SII funds and investments have been active for less than 5 years, so longer term outcomes cannot yet be measured. We expect that this information will emerge over time, although it remains to be seen whether it will be measured effectively. We also observe that longer term outcomes are often dependent on external economic factors and so do not have such strong links to short term

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48 STREAT The Cromwell Manor development, STREAT, 2015
49 SVA Social Impact Fund report, Social Ventures Australia, 31 December 2015
50 Beacon Foundation National Outcomes Report, Beacon Foundation, 2014
51 Indigenous Jobs and Training Review – Mihaven’s submission, Mihaven, 2013
52 Evaluation of Victorian children’s centres, Department of Education and Early Childhood Development, August 2008
53 Homes for Good Investments Impact Report Quarter 3, 30 June 2015
outcomes.

- What we can observe is that successful programs and services increase the human capital and capability of individuals to go on to achieve these outcomes, e.g. by providing them with work experience / training or secure housing.
- A study of the UK social investment market in 2013[^34] found that SII funds were expected to make a positive economic contribution to the UK economy but that only half were generating enough revenue to cover the cost of running the fund without cross subsidies from other activities or external funding.
- Evaluation reports observe that SII funds offer a mechanism by which social enterprises access capital that they otherwise would have found difficult to access[^55]. This facilitated the achievement of the outcomes noted above. From this perspective, SII funds meet unmet demand, are contestable and have contributed to potentially effective and efficient service delivery.
- Similarly, the financial returns generated by the funds were not usually disclosed to the public. We have assumed that SII fund portfolios are meeting the fund’s internal return targets.

Stimulate and support innovation

- SII funds (as with SIBs) support innovation to the extent that they fund expansion to existing innovative programs – they may be unsuited to funding high risk pilots of new, untested innovations. This is because SII funds apply specific assessment criteria to potential investments in order to identify organisations able to demonstrate evidence for the effectiveness of their programs or services, as well as aligned objectives, appropriate management ability, governance, and reasonable capability for scaling up and maintaining a loan[^56]. This reduces the risk that organisations will fail to achieve impact and/or default on their loans and is in line with the risk appetite of their investors.
- For higher risk pilot programs, philanthropic or grant funding remains the main channel of funds.

Scale up services to meet unmet need

- SII funds tend to focus on priority areas where there is significant unmet need (such as employment, education and training, particularly for at-risk youths; affordable housing; disability and mental health services; financial inclusion); the target outcomes for these areas can be clearly linked to government fiscal benefits as well as positive individual outcomes.
- Some organisations are located in specific communities which are considered disadvantaged. For example, Big Society Capital invests in a fund that targets the deprived areas of the North East of England whilst the Ulster Community Investment Trust provides loans for social enterprises in Northern Ireland.

Increase service provider and sector capability and capacity

- Our desktop review suggests that SII funds have had success with facilitating the development of the impact investing market. The investment activities of these funds have helped to raise the profile of SIIs within the NGO sector as well as increase the size of the amounts invested. Several fund evaluation reports (e.g. Inspiring Scotland[^57], Foresters[^58]) noted that their capability building efforts (providing support and expertise to social enterprises) were important to help organisations identify if debt finance was suitable for them, and if so how to effectively plan and implement the additional funding. Outcomes and impact measurement was a particular area where organisations needed support.
- SEDIF, as well as other funds, noted that ongoing effort is required to increase the capability of the social enterprise sector to measure performance and take on additional investment; organisations are traditionally used to grant funding which has no risk to the provider and so are wary of taking on the financial risk of debt finance.

[^34]: “Growing the Social Investment Market: The Landscape and Economic Impact”
[^57]: Evaluation of the Link Up Programme, Inspiring Scotland, October 2014
[^58]: Foresters Community Finance Annual Review, Foresters, November 2014
### Assessment criteria | Observations
--- | ---
Increase transparency, accountability and performance | - SII funds tend to display transparency and accountability around their objectives, selection criteria and investments. We found that:
  - Most had clearly stated, well-defined objectives and show transparency in how they select their investments. Funds often published the assessment criteria which they use to select investments - determining the extent to which potential investments align with their objectives, are evidence-based, address unmet need and are likely to benefit from capital.
  - Some published outcome measurement frameworks with a range of potential measures (for example, Big Society Capital’s Outcomes Matrix\(^{59}\) to assist social enterprises with identifying their own target outcomes and appropriate measures, as well as supporting them through specialist advice. Some funds observed that this was found to be quite useful by smaller organisations who had little experience with outcomes measurement or raising non-grant funding.
  - However, we found that SII funds generally did not provide an overall, consolidated measure of the outcomes of their investment portfolio. One possible cause is that many services and programs are delivered by smaller and/or community based social enterprises who (although required to report on outcomes achieved) have varying capabilities to do so. Instead, SII funds tend to provide some measures of the outputs of their portfolio (e.g. number of clients or houses built) while summarising the impacts of a selection of organisations via case studies. Several of the case studies demonstrated realised benefits, however we were unable to verify if these were representative of the fund’s overall experience. It is possible that more comprehensive impact information is provided to investors as distinct from the general public. The exception to this was some of the US Social Innovation Fund (SIF) funds which provided detailed evaluation reports. For example, National Fund for Workplace Solutions\(^{60}\), which had “statistically significant positive effects on the general (non-focus industry) employment rates of participants” and REDF fund which saw “Social enterprise workers moved toward economic self-sufficiency and life stability...although the statistical significance of these observations is mixed.”\(^{61}\).
  - Similarly, the financial returns generated by the funds were not usually disclosed to the public. We have assumed that SII fund portfolios are meeting the fund’s internal return targets.

#### 3.2.2 Other community development financial institutions

CDFIs provide finance to both individuals and businesses (including social enterprises) and are sometimes not recognised as SII; however they share the same dual purpose of SII in terms of generating both financial and social returns.

Evaluations of CDFIs in the UK, US, Canada and Australia have consistently found that CDFIs address market failure by assisting individuals and enterprises in disadvantaged areas to access capital at affordable rates\(^{62}\).\(^ {63}\). In this sense they can be considered to be a contestable mechanism that addresses unmet need, with clearly stated, well-defined objectives and target cohorts who experience financial exclusion.

For individuals, the only market alternatives may have been payday lending or advance welfare benefits; for enterprises, grant funding would have been the only option (in the event that they were able to

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62 Community Development Finance Institutions (CDFIs), A new option for addressing financial exclusion in Australia, Social Ventures Australia, December 2009


The report estimates that UK CDFIs contributed over GBP 500m to SMEs and GBP 78m to social enterprises in 2014, particularly in disadvantaged areas. It also estimated that CDFIs helped create 11,500 new businesses, supported over 20,000 jobs three-quarters of which were new jobs, and helped over 40,000 financial excluded individuals over 2014.
secure this). The Australian evaluation found that this was particularly true for indigenous clients who are over-represented in the use of expensive non-mainstream credit\(^{64}\).

Several evaluations also found that CDFIs provided useful advice on understanding and managing finances and addressing financial needs (e.g. repaying debt) with the aim of increasing the capability of individuals to manage their future finances.

However, it is unclear as to whether CDFIs offer value-for-money to governments as providers generally struggled with outcomes measurement and achieving long term sustainability.

A recent report from the UK that CDFIs in 2014 have contributed over GBP 500 million to SMEs mostly in deprived areas and including GBP 78 million to social enterprises in 2014. It is estimated that CDFIs in 2014 have helped create 11,500 new businesses, supported over 20,000 jobs, three-quarters of which were new jobs, and helped over 40,000 individuals that are financially excluded\(^{65}\).

- CDFI evaluations struggled to measure the outcomes and impact achieved by the overall CDFI sector, instead describing key outputs and case studies. This is not to suggest that CDFIs fail to achieve outcomes or do not facilitate long term impact; rather, it indicates that the sector has difficulty with defining, measuring and reporting on longer term outcomes. Some studies have noted that this is due to the difficulty of tracking individuals over time and with attributing success to CDFI finance as distinct from other supports that are usually received in tandem.

- Another key theme commonly noted was the difficulty CDFIs have with achieving long term self-sustainability. In the UK and US, CDFIs have only been able to sustain themselves without further grant funding if they reach a large size and are located in an area with substantial demand for their services. Smaller CDFIs (including the pilot CDFIs in Australia) were unable to cover their operational costs with interest from their capital pool and loans alone, and require further subsidies or grants to continue providing their services\(^{66}\). Lack of economies of scale and the more intensive support provided to clients were cited as key drivers.

### 3.3 Direct investment in social enterprises

Direct investment in social enterprises by private and institutional investors (and sometimes government) is an alternative form of SII which is tailored specifically to a social enterprise. It encompasses a range of forms which vary in terms of their investment and legal structure, complexity, scale and flexibility, and is usually aimed at providing growth capital to support an increase in scale or working capital to sustainably support ongoing operations.

For further details on direct investment and social enterprises, refer to Appendix A.

In assessing the evidence for direct investment in social enterprises, we have considered the effectiveness and efficiency of social enterprises in general and impact reports for individual social enterprises.

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<th>Assessment criteria</th>
<th>Observations</th>
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<tr>
<td>Value for money, contestability and transfer of risks</td>
<td>• There is insufficient evidence to conclude on the Australian social enterprise sector’s value-for-money as there is limited information on the social enterprise sector in general. We note that research into the sector is currently being performed through the Finding Australia’s Social Enterprise Sector (FASES) research initiative which is being conducted by Swinburne University in partnership with Social Traders, a social enterprise intermediary. Research in 2010 estimated that there were 20,000 social enterprises in Australia, with the number increasing by 7% per annum over the previous five years(^{67}).</td>
</tr>
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</table>

\(^{64}\) Alison Plant, Sue Warth, Community Development Financial Institutions Pilot Evaluation, Department of Families, Housing, Community Services and Indigenous Affairs, February 2013

\(^{65}\) http://responsiblefinance.org.uk/2015/12/responsible-finance-the-industry-in-2015/

\(^{66}\) Alison Plant, Sue Warth, Community Development Financial Institutions Pilot Evaluation, Department of Families, Housing, Community Services and Indigenous Affairs, February 2013

\(^{67}\) Social Enterprise in Australia: a preliminary snapshot, Finding Australia’s Social Enterprise Sector, June 2010
We found evidence of benefits from individual social enterprises where they are able to systematically report the social and economic impact of their activities. This was limited to larger, established enterprises such as Goodstart and STREAT; most sector participants are smaller in size and have little or no outcomes measurement capability.

Whilst the findings relating to Australian social enterprise are limited, the findings from the UK are more substantive and suggest that social enterprises can be a major economic force contributing to GDP and creating and sustaining a significant number of jobs. UK social enterprises feature in the local economies of many deprived communities and provide jobs for the most disadvantaged. UK social enterprises also make significant contributions to the delivery of public services, offering an alternative organising model to traditional charity/not-for-profit and for-profit models.

We found that there was significant variability in the level and quality of results and outcomes information provided by social enterprises, suggesting that direct investment in social enterprises may not provide transparency and accountability unless requirements are embedded into contracts.

Social enterprises generally did not provide outcome measures and appeared to have varying capabilities to do so. Instead, their annual reports tended to provide some measures of the outputs of their portfolio while summarising the results for a sample of case studies. Several of the case studies demonstrated realised benefits, however we were unable to verify if these were representative of the fund’s overall experience. It is possible that more comprehensive impact information is provided to investors as distinct from the general public.

We observe that social enterprises are increasingly accessing finance from a range of sources including SII funds and CDFIs however the scale of capital required is often too small to be eligible for these sources. The use of legal structures that facilitate equity capital as well as debt offers the potential to attract a broader set of investors.

In the UK a tax incentive for investors has been introduced to stimulate direct SII in social enterprises, Social Investment Tax Relief. Although the initial Social Investment Tax Relief legislation was limited in size and eligibility it serves to reduce the cost of capital for social enterprises and applies to both debt finance and equity. It is anticipated that the changes will remove barriers and increase the number of investors using the tax relief and reducing the cost of investment by 30%.

Refer to Appendix A for further detail on legal structures and tax impacts.

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**Assessment criteria** | **Observations**
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We found evidence of benefits from individual social enterprises where they are able to systematically report the social and economic impact of their activities. This was limited to larger, established enterprises such as Goodstart and STREAT; most sector participants are smaller in size and have little or no outcomes measurement capability. | Social enterprises are well represented in education and child care, business and financial support, employment services, retail, social care, culture and leisure, health care, environment, creative industries and housing.

The UK study into social enterprises found that accessing finance is generally recognised as a barrier to growth and start-up. Over four out of ten UK social enterprises have sought finance or funding over the previous year which is substantially higher than comparable SMEs. The preference is still to seek grants with four out of five applying for grants with one in four seeking debt finance. However, the median amount of finance that is needed is GBP 60,000 which is below the threshold for many of the SII funds.

Given the similarities between Australia’s and the UK social enterprise sector, this suggests there is considerable potential for direct investments by private investors.

We found that there was significant variability in the level and quality of results and outcomes information provided by social enterprises, suggesting that direct investment in social enterprises may not provide transparency and accountability unless requirements are embedded into contracts.

Social enterprises generally did not provide outcome measures and appeared to have varying capabilities to do so. Instead, their annual reports tended to provide some measures of the outputs of their portfolio while summarising the results for a sample of case studies. Several of the case studies demonstrated realised benefits, however we were unable to verify if these were representative of the fund’s overall experience. It is possible that more comprehensive impact information is provided to investors as distinct from the general public.

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68 The People’s Business, Social Enterprise UK, 2013; UK government statistics identify around 70,000 social enterprises which contribute GBP 24 billion to the economy and employ nearly a million people. Over one in ten are small with annual turnovers less than GBP 10,000 and over one in six are large and have annual turnovers exceeding GBP 1 million.
69 ibid
70 ibid
In conclusion, the desk research and interviews undertaken by EY confirm that there continues to be a lack of evidence of measurable benefits of SII. There continues to be limited evidence of realised financial benefits for government, both nationally and internationally, primarily due to the developing nature of the sector and the early stage of many existing SIIs.

Key observations:

► Social impact bonds provide examples of positive performance and savings to government; however overall evidence is limited as many instruments are not mature, and reporting is not consistent and may be selectively biased.

► SII funds have played a key role in sector capability development, but there is a lack of systematic evidence of value for money for government due principally to variable reporting approaches.

► There is limited evidence on SII by private investors in social enterprise in Australia; the more substantive evidence base in the UK suggests benefits can be realised – although reporting focusses on direct outcomes rather than impact for government.
4. Potential for social impact investments in key government areas

The realised evidence from SIIs to date suggests that there are several areas of social need where a SII approach may be useful for Australian governments to more efficiently and effectively achieve their objectives. We have identified the following policy areas where the Commonwealth Government might consider using a SII approach in order to achieve its goals:

► Early education and child care
► Employment, further education and training
► Social and affordable housing
► Aged care
► Financial inclusion
► Health
► Disability services

It is important to note that our focus has been on areas where there may be potential budget savings or improved service delivery for Commonwealth Government. However, we will also comment on areas where the Commonwealth may achieve broader social benefits and/or where state governments are the main service providers (e.g. child and family services, social housing). The following areas have potential but have not been investigated either due to limited evidence, or primacy of state government responsibility: child and family services including family violence; justice; social cohesion including place based mechanisms and collective impact; Indigenous affairs; and international development.

While we have discussed our conclusions by area, we observe that social issues and responses are complex and often interrelated:

► SII provide a mechanism by which responses can be targeted to specific population cohorts. The table below summarises the interaction between many of the policy priority areas and some of the specific age cohorts targeted by SII initiatives.

► Figure 1 highlights the inter-relationship and complexity of vulnerabilities, which can be best addressed by integrating multiple services and using intensive case management or co-ordination. In the context of SII this emphasises the importance of provider consortia, the need for collaboration between government agencies, and the complexity in estimating overall government cost savings.

For further reference, background material providing definitions and classifications for SII, assessment criteria and a summary of potential benefits for the Commonwealth Government is provided in Appendix A.
### Table 1: Example target cohorts for SII propositions

<table>
<thead>
<tr>
<th>Policy field</th>
<th>Age cohorts</th>
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<tr>
<td></td>
<td>0-5</td>
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<tr>
<td><strong>Education</strong></td>
<td>Early education</td>
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<tr>
<td><strong>Health</strong></td>
<td>Basic health milestones</td>
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<tr>
<td><strong>Employment</strong></td>
<td>Learning about work and work placements</td>
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<tr>
<td><strong>Housing</strong></td>
<td>Safe home Out of home care / fostering</td>
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### Figure 1: Illustration of outcomes hierarchy
4.1 Early education and childcare

Early education and childcare - overall findings

We found a range of SII mechanisms, PbO and social enterprise activities in relation to early education and childcare which demonstrated some realised benefits:

► The Utah SIB expands the scale of an innovative preschool program for children from low income families and its first year results provide some evidence that it is leading to improved education outcomes and realisable cost savings to government (in the form of children not requiring intensive special education services during their primary education)\(^{72}\).

► The USA’s Social Innovation Fund provides outcomes based grants to an evidence based early years learning program which improves education outcomes including for vulnerable children and children with disabilities\(^{73}\).

► A range of PbR mechanisms and SII fund loans in the UK and Europe have funded an expansion in early education and childcare programs premised on improved education outcomes and short and long term cost savings to government. The trial PbO mechanism for UK Children’s Centres has had mixed results due to a payment mechanism which did not in all areas incentivise a focus on outcomes\(^{74}\).

► The Australian social enterprise Goodstart is backed by direct investment from government, a mainstream bank and a pool of social investors and provides accessible child care services using a commercially viable operating model\(^{75}\).

These findings suggest that SII could be applied in Australia to expand place-based community social enterprises that address specific geographic or community unmet needs, or to scale up existing programs or initiatives that can demonstrate a successful track record in meeting the specific needs of children with disabilities or from vulnerable and disadvantaged backgrounds.

We note that Commonwealth and state governments share education responsibilities and so any cost savings would be shared. If justifying early education and childcare SII on the basis of cost savings then state and Commonwealth governments may need to conjointly develop such an investment, as some cost savings might be generated for primary or secondary education years (i.e. at state government level).

Overview of government objectives

There is an extensive body of Australian and international research which shows that experience in the first few years of life has a significant impact on an individual’s subsequent development\(^ {76} \). Quality early education is linked to positive primary and secondary education outcomes, and (in conjunction with other individual, family and environment factors) is associated with positive broader life outcomes including attainment of higher education levels, better employment and wellbeing outcomes\(^ {77} \). Early education has been shown to yield the highest benefits for children who come from disadvantaged backgrounds who may lack other support factors\(^ {78} \). Accessible and affordable childcare, meanwhile, helps to support increased parental participation in the workforce\(^ {79} \).


\(^{74}\) Payment by Results in Children’s Centres Evaluation, UK Department for Education, J une 2014


\(^{77}\) Investing in the Early Years – A National Early Childhood Development Strategy, Council of Australian Governments, 2 J uly 2009

\(^{78}\) Investing in the Early Years – A National Early Childhood Development Strategy, Council of Australian Governments, 2 J uly 2009

\(^{79}\) Submission to the Productivity Commission of Australia, Inquiry into Child Care and Early Childhood Learning, Workplace Gender Equality Agency, 31 J anuary 2014
The Commonwealth Government’s overall objective is to provide all families with access to quality, affordable early education and childcare options. Early learning and childcare (ELAC) services are one of the few areas which belong mainly to Commonwealth Government with limited involvement at a state level. The Commonwealth Government:

► Funds universal (optional) access to early education.
► Supports development of early education and childcare service capacity in geographical or specific needs areas which have unmet demand, such as in regional, rural and disadvantaged areas, indigenous communities or for children with high needs (e.g. autism). This takes the form of funding for subsidies for community providers.
► Supports development of early education and childcare service sector capability.
► Supports innovation and best practice in the early education sector (e.g. by providing grant funding for pilot programs to build an evidence base for effective interventions).
► Provides financial assistance to lower income families to support basic living costs (e.g. family tax benefit) and the cost of childcare (e.g. child care benefit). The government also provides a child care rebate which is not means tested.

Areas of unmet demand or market failure

The Productivity Commission’s 2014 review into early education and childcare observed that the Commonwealth Government is the largest funder of the sector, with outlays exceeding $5bn a year and growing. It noted specific areas of unmet demand, including:

► a shortage of quality child care and early learning options that are accessible, affordable and flexible enough to suit different work arrangements
► a small but significant number of children who start school with learning and developmental delays
► shortages of quality options to meet the needs of children with disabilities, vulnerable children, regional and rural families (particularly indigenous communities) and parents who are moving from income support into study and employment

The Commonwealth Government has programs which aim to fund or subsidise the provision of these services (e.g. Early Learning and Care Centres program), however limited funding constrains the reach of these services. The Productivity Commission also noted that current arrangements are complex and costly to administer, difficult to navigate, and sometimes poorly targeted.

Potential application of SII in Australia

ELAC has been a key focus area for social enterprises. In recent years, SII has been used to expand the scale of evidence-based programs targeting children with specific needs, or to scale up the capacity of large, established ELAC providers. Examples that have demonstrated positive outcomes to date include:

► The use of a SIB to expanding the scale of an innovative preschool program for children from low income families, with evidence showing its ability to lead to improved primary school education outcomes (Utah SIB).

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82Productivity Commission Inquiry Report No.73, Childcare and Early Childhood Learning, Australian Government Productivity Commission, 31 October 2014
83Productivity Commission Inquiry Report No.73, Childcare and Early Childhood Learning, Australian Government Productivity Commission, 31 October 2014 (pg.2)
The use of an outcomes focused approach to deliver, manage and support an evidence-based early learning program which has been shown to deliver improved primary school education outcomes and is able to address the needs of children with disabilities or vulnerable children (US Head Start).

The use of payment by results contracts or loans from SII funds to expand the scale of children's centre providers, particularly those servicing disadvantaged communities. As part of their social purpose, some of these centres have an integrated approach and also offer early intervention parenting skills programs and links to other support services (UK Children's Centres, London Early Years Foundation, UK 4Children, Germany's Kinderzentren Kunterbunt).

We note that the trial payment by results example, UK Children's Centres, had mixed evaluation results with an “ineffective” payment scheme that only lead to some local areas demonstrating greater focus on their core purpose of improving outcomes for children and families85.

Takeover of a large failed child care provider by a public/private consortium, with the aim of turning it into a social enterprise and delivering quality child care services to all its families (GoodStart Australia).

Comparing these to the areas of unmet demand highlighted by the Productivity Commission indicates where (based on the evidence to date) there are potential opportunities for SIIs to harness private and government funding to improve ELAC service delivery.

Shortages specific to geographic areas or individual communities

Shortages specific to certain areas or communities can be an indication that it is not prima facie economically viable to provide ELAC services without some form of subsidy (e.g. as a result of low population density and low economies of scale). There may also be complexities to the local operating environment which are unknown to organisations outside the community.

These factors suggest that there may be opportunities for community based SII to address local market failure, in conjunction with some degree of government funding or subsidy including potential PbR mechanisms. A successful SII would be based on the experience of an existing provider with significant community involvement. One option might be a partnership between a place-based organisation and an established early learning service provider. An alternative option could be to fund extra centre(s) run by an established ELAC provider who operates in other communities with similar characteristics. Germany's Kinderzentren Kunterbunt social enterprise, for example, establishes new centres in partnership with employers or communities with the aim of having them self-sustain in the longer term86.

This SII approach is place-based and so would be best suited to an investment from a SII fund (who would be able to provide support to the local provider to fill unmet need), or to an outcomes based contract under a wider government outcomes based framework, in conjunction with existing programs that subsidise operational costs for some providers in disadvantaged areas.

Unmet needs of children with disabilities or from vulnerable or low income backgrounds

Where existing services are not meeting the specific needs of children (e.g. children with disabilities, children from vulnerable or low income backgrounds), it may be possible to use SIIs to scale up existing programs or initiatives that can demonstrate a successful track record in meeting these needs (US’ Utah SIB87 and Head Start88 are good examples of this in practice).

A SII would be cost effective if the provider can show the link between improved education outcomes and government cost savings over what the program would cost to deliver. For example, this could take the form of reduced demand for special needs classes or intensive programs addressing learning and developmental delays. Longer term hypothesised benefits (such as...

85 Payment by Results in Children’s Centres Evaluation, UK Department for Education, June 2014
86 http://www.schwabfound.org/content/bj%C3%86m-zzinczoll
improved employment outcomes), although likely to be an aim of the program, potentially supported by other sources of evidence, may be considered too uncertain to include in an assessment of a program's effectiveness.

We note that in Australia, any such government cost savings would occur during primary or secondary education which is a state government area of expenditure. This might mean that this type of SII would need to occur at a state government level, or that state and Commonwealth governments would need to conjointly develop such an investment.

4.2 Employment, further education and training

Employment, further education and training - overall findings

Increasing participation in employment, further education and training is a core responsibility for government and one of the main focus areas of SIIs as well as the overall social services sector.

We found a number of Australian and international SII examples at an individual program or social enterprise level which demonstrated positive outcomes over the short term (successful completion of work placements, increased skillsets and sustained employment over the program duration), although organisations found it difficult to measure longer term employment outcomes and so did not do so (e.g. sustained employment 12 months after the intervention).

We also reviewed evidence for UK and US government commissioned jobseeker support services, which are funded on a PbR basis and represent SII at a nationwide level. Results from these schemes were mixed, with some reports highlighting implementation issues and suggesting that this approach was ineffective for harder-to-place individuals with higher needs.

These findings suggest that SII can be applied in the Australian context in a number of ways:

► For the Commonwealth Government’s new jobactive program, some elements of PbR are already incorporated. Improvements in employment outcomes may be best achieved by refining the current approach to reflect the evidence from the UK and US on what is effective or ineffective, and by periodic outcomes monitoring and evaluation.

► For social enterprises that address employment and training needs at a local level, SII offers a way of expanding services and innovative, evidence-based programs. Given the smaller scale of these organisations, this is perhaps best achieved through the use of intermediary funds or smaller scale outcomes based contract schemes. There is also a need to build the capability of organisations to identify and measure outcomes, both in the short and longer term.

► Direct investment in SII has also realised benefits in Australia (for example, through STREAT’s public private partnership89) and there may be a government role in stimulating and facilitating this activity. This could take the form of a fund which provides some grant / loan funding for successful proposals and may require Government to set up a centre/taskforce focused on this, carry out info exchange / market building workshops and work with providers to solicit and then develop proposals of interest – similar to what has taken place in the states.

Overview of government objectives

Helping people find and maintain good quality, secure employment is a key objective of all governments. Employment is linked to a broad range of positive individual, family, fiscal and social outcomes, including reduced benefits dependency, sustained housing, better health and aged care outcomes, reduced likelihood of involvement with the justice system, financial and social inclusion and a higher quality of life. Initiatives that lead to positive employment outcomes can have significant benefits for government, both in the short and longer term.

Fundamental to this is a second role of government: to enable access for individuals to quality and affordable further education and training so that they can upskill themselves and transition into employment.

It is important to note that governments are also responsible for supporting and stimulating jobs growth through sound economic management and a positive business operating environment. For individuals to achieve employment, the opportunities need to exist in the first place.

From a fiscal perspective, the Commonwealth Government:

- Provides financial assistance to eligible individuals who are unemployed, employed with low incomes, unable to work or undergoing education/training.
- Funds programs for cohorts at risk of poor employment outcomes and long term welfare dependency, aimed at addressing their barriers to employment, education or training.

Areas of unmet demand or market failure

Although Australia's overall unemployment rate (around 6%) remains relatively low compared to other developed economies, young people continue to experience difficulty with obtaining employment. Australia’s youth unemployment rate has slowly increased over the first quarter of 2015, with an estimated 11% of 15 - 24 year olds not in employment, education or training (OECD Employment Outlook). This varies regionally and youth unemployment can be 20% or more in some areas. This is particularly concerning as unemployed young people are less able to obtain employment, more likely to progress to long term welfare dependency and broader poor life outcomes.

Other groups which experience higher unemployment include populations living in certain regional, remote and disadvantaged areas; indigenous communities; individuals with disabilities or mental health issues; and the long term unemployed.

From an employer perspective, the Commonwealth Government lists a number of skilled trades as being in short supply. A significant fall in students commencing and completing vocational education is expected to exacerbate this problem in the future.

Potential application of SII in Australia

Employment, education and training have always been some of the main focus areas for the social enterprise sector, and this has translated to SII given the significant impact of achieving employment or education / training outcomes. Our desktop review identified many examples of SIs which provide working or growth capital to organisations aiming to address barriers to employment (including lack of skills / training, individual attitudes and behaviour, housing issues) and/or provide work placement opportunities for clients to gain work experience. Although we found that organisations found it difficult to measure longer term employment outcomes (e.g. maintaining employment 12 months after completing a placement), there were several examples which demonstrated positive outcomes at least in the short term after intervention:

- The use of SII funds and SIBs, debt finance or outcomes based contract mechanisms to expand the scale of innovative early intervention programs for teenagers at risk of not transitioning to employment, education or training. Participants in these programs showed improvements in measures linked to successful transition to further education and training, such as engagement,

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95 Sue Richardson, What is a skill shortage?, National Centre for Vocational Education Research, 2007
SII might be applied in the Australian context in a number of ways:

- Equity investment (via a joint public-private consortium) and debt finance (via SII funds) to provide growth capital for social enterprises with a strong track record of providing work placements and wraparound services to youths who have multiple issues and are at risk of homelessness. (SVA fund – STRSTRE and Beacon Foundation; Social Impact Scotland – Aberdeen Foyer).

- Debt finance from SII funds to provide working / growth capital for social enterprises which provide training and work placements for individuals at risk of long term unemployment, including youths from a low income background, individuals with disabilities or mental health needs, indigenous jobseekers (SVA - PGM Refiners and Ability Enterprises; SEFA – MiHaven; UK Impact Ventures – K10; US National Fund for Workplace Solutions; US REDF; UK Key Fund – Paperworks).

- New Zealand’s application of the investment approach to assess the longer term effectiveness of different initiatives aimed at supporting participants to re-enter the workforce and reduce their welfare dependency. The Commonwealth Government is currently developing a similar model.

We also identified a number of nationwide jobseeker support services (UK Work Programme, US Work Programme) funded using payment by results contracts. Results from these schemes were mixed, with some reports highlighting implementation issues and suggesting that this approach was ineffective for harder-to-place individuals as providers tended to concentrate on easier cases. The Commonwealth Government’s new jobseeker support services scheme, jobactive, is largely PbR focussed.

The range of these examples (including Australian examples for each category) indicates that potential SII opportunities can already be identified and explored within the existing Australian social enterprise sector. Programs will be cost effective for the Government if they lead to a significant proportion of participants maintaining employment over the long term, reducing benefits expenditure (as well as the cost savings associated with their improved life outcomes).

SII might be applied in the Australian context in a number of ways:

- For the Government’s new jobactive program, elements of PbR are already incorporated. Improvements in employment outcomes may be best achieved by refining the current approach to reflect the evidence from the UK and US on what is effective or ineffective, and by periodic outcomes monitoring and evaluation.

- For social enterprises that address employment and training needs at a local level, SII offers a way of expanding services and innovative, evidence-based programs. Given the smaller scale of these organisations, this is perhaps best achieved through the use of intermediary funds, such as the funds established through the SEDIF initiative, or smaller scale outcomes based contract schemes.

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An example could be a scheme focused on commissioning outcomes relating to skilled trade apprenticeships in areas where there are shortages.

There is also a need to build the capability of organisations to identify and measure outcomes, both in the short and longer term. Intermediary funds could be funded by government to do this; alternatively, the government might consider setting up information and advice workshops in a similar fashion to NSW's Office of Social Impact Investment.

- Direct investment in SII has also realised benefits in Australia (for example, through STREAT’s public private partnership) and there may be a government role in stimulating and facilitating this activity. This could take the form of a fund which provides some grant / loan funding for successful proposals and may require Government to set up a centre/taskforce focused on this, carry out info exchange / market building workshops and work with providers to solicit and then develop proposals of interest – similar to what has taken place in the states.

4.3 Social and affordable housing

Affordable housing - overall findings

Affordable housing is a fundamental base for economic and social outcomes. Similarly to employment and education, and most effectively in conjunction with these, it is a key focus area for SII and the broader social sector.

We found a range of Australian and international SII examples which demonstrated some positive benefits to individuals and government in the first few years of the program. These programs are relatively recent and so are not currently able to demonstrate longer term hypothesised outcomes (such as increased workforce participation and successful transition to unsupported housing); these longer term outcomes are the main drivers of potential Commonwealth Government cost savings. Examples include:

- There are a number of examples of social enterprises or housing associations sourcing capital from intermediaries to develop and/or purchase affordable rental housing for target cohorts, including SEFA’s 3 Sista’s loan and UK affordable property funds such as Real Lettings. Some providers also use finance to scale up support services being provided to tenants. Realised benefits include tenants being able to sustain their tenancies and so maintain quality housing, improved health and wellbeing outcomes.
- Direct investment in affordable housing via housing bond issues (e.g. Canada’s Toronto Community Housing Corporation Bond\textsuperscript{112}).

Some consider the Commonwealth Government’s National Rental Affordability Scheme to be a form of SII in that it incorporates PbR elements (private investors receive incentives for developing affordable housing units). The scheme has shown mixed results: the number of actual dwellings built is considerably less than initial targets and there has been limited success in attracting private investment into the affordable housing sector. However, the scheme appears to be at least more cost effective than the previous Social Housing Initiative on a cost per unit basis and it will add a significant number of affordable housing units for at least the next 10 years\textsuperscript{113}.

Experience from international jurisdictions suggests that SII capital could be effectively harnessed in Australia to increase the supply of affordable and social housing, provided certain structural barriers are addressed. Potential approaches include:

- Increased capital made available (via intermediary funds) for community-led housing developments, as well as for capability building to enable smaller organisations to access capital, define and measure short and longer term outcomes.
- Facilitating greater direct institutional investment in affordable housing projects via legal and regulatory change; for example, by enabling a market for housing bonds which medium to large


\textsuperscript{113} National Rental Affordability Scheme: Economic and Taxation Impact Study, Bond University, December 2013
social enterprises can issue to access finance.

We note that SII is aimed at increasing the Commonwealth Government’s ability to meet its housing objectives but may not lead to significant fiscal benefits. This is because affordable housing involves a degree of ongoing government subsidy which may offset reduced benefits expenditure and increased tax revenues from any realised improved employment and productivity outcomes. We also note that affordable housing has higher rental rates than social housing and so tenants are not as disadvantaged as those who require social housing.

Finally, there are strong links between stable, quality housing and improved health and justice outcomes, which (if realised) lead to reduced service expenditure. However these benefits are accrued to state governments rather than the Commonwealth. The role of SII in promoting innovation across agency boundaries may be effective here, for example addressing complex needs across housing, employment and education, rather than a single intervention in isolation.

Overview of government objectives

Quality and affordable housing is a fundamental aspect of a person’s wellbeing. Numerous studies detail the role that housing affordability plays in shaping Australian economic and social outcomes at both an individual and national level. The 2015 Senate paper on housing affordability notes that housing “can profoundly influence educational attainment, employment outcomes, physical and mental health and social participation” as well as having long term flow on effects to children’s development and intergenerational wealth inequality.

Both state and Commonwealth governments have responsibilities around improving the supply and affordability of housing. State governments fund and deliver social housing and specialist services for persons experiencing homelessness, and administer state level affordable housing initiatives. Commonwealth Government provides financial assistance to low income households to ease rental stress and administers the National Rental Affordability Scheme (NRAS) (aimed at addressing a shortage in affordable rental housing via financial incentives for investors to build and rent housing to low / moderate income households at below market rates). It also funds the social housing and homelessness services delivered by state governments.

Areas of unmet demand or market failure

Despite government financial assistance for low income earners, researchers are generally of the view that there is an increasing shortage of affordable housing in Australia concentrated in metro areas where job markets are centred. This has been attributed to a range of drivers, including growth in housing prices outstripping income growth and social housing supply unable to keep up with population growth and demand. According to ABS statistics, in 2013-14 50% of lower income renter households were experiencing rental stress (i.e. paying more than 30% of income on housing costs).

In addition, indigenous home ownership rates are much lower than for the general population and indigenous communities face greater barriers to sustained housing, including greater levels of financial exclusion and lower income levels.

Potential application of SII in Australia

Social enterprises have been involved with developing and maintaining affordable housing in Australia for many years, although the level of capital required has limited this to larger, well established organisations. Internationally, the private sector (institutions, private investors and foundations) have played a much larger role in expanding affordable housing projects. (This reflects a number of differences in the Australian housing market and regulations which we will touch on later.)

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114 Out of reach? The Australian housing affordability challenge, Senate Economics References Committee, May 2015
Examples of SII in affordable housing which demonstrated positive benefits to individuals and government include:

► Debt finance from SII funds to provide development capital and capacity finance for social enterprises or housing associations developing / purchasing affordable rental housing. Housing is sometimes targeted specific groups, including indigenous persons, people with disabilities, individuals and families on benefits (SEFA – 3 Sista’s; UK Real Lettings Property Fund; UK Homes for Good; UK Golden Lane Housing).

Alongside this, SII fund finance can also be used to provide working capital to scale up support services being provided to tenants, to help them sustain their tenancies. There is some overlap between funding for housing and funding for support services aimed at improving employment and health outcomes.

► Capital raised via housing bonds to fund similar developments or purchases of social or affordable housing (Canada’s Toronto Community Housing Corporation Bond; UK Derwentside Homes).

► The Commonwealth Government’s NRAS, which some consider to be a form of SII in that it incorporates payment by results elements in the form of financial incentives for private investors to build and rent housing to low / moderate income households at below market rates. The scheme has shown mixed results. It originally aimed to provide 50,000 additional affordable rental dwellings by June 2016; the actual number is expected to be around 35,000. It has also had limited success with attracting private investment into the affordable housing sector with more charities than private investors as operators. However, the scheme appears to be at least more cost effective than the previous Social Housing Initiative (albeit this focused on social housing), and has added a significant number of affordable housing units to the nationwide pool for at least the next 10 years.

Several characteristics of affordable housing developments lend themselves to effective SII, including stable and long term cashflows (subsidised by government), solid assets on which to secure loans, strong capacity to scale and replicate, and evidence-based links to positive social impacts and government benefits.

The experience from international jurisdictions suggests that SII capital could be effectively harnessed in Australia to increase the supply of affordable and social housing, provided certain structural barriers are addressed. Potential approaches include:

► Increased capital made available (via intermediary funds) for community-led housing developments. Proposals that are owned or in partnership with a social enterprise are more likely to have social impact (rather than financial return) as their main objective. One option could be affordable housing focused SII funds as in the US and UK. As with other areas, there is also a need to build the capability of organisations to identify and measure the outcomes they target, both in the short and longer term.

► Facilitating greater direct institutional investment in affordable housing projects via legal and regulatory change. In the UK, US and Europe, private sector involvement in affordable housing developments is much higher than in Australia due to a number of structural differences. UK housing trusts and organisations, for example, can issue housing bonds to access external capital.

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122 Alternative Source of Capital for the Social/Affordable Housing Sector in Canada, BC Housing, August 2015
123 The Progress Report to the Council of Australian Governments from Commonwealth, State and Territory Housing Ministers, Council of Australian Governments, November 2009
124 Vivienne Milligan, Hal Pawson, Peter Williams, Judith Yates, Next Moves? Expanding affordable rental housing in Australia through institutional investment, March 2015
In assessing the cost effectiveness of SII for affordable housing, we observe that investments will increase the Commonwealth Government’s ability to meet its housing objectives but may not lead to significant fiscal benefits. This is because affordable housing involves a degree of ongoing government subsidy which may offset reduced benefits expenditure and increased tax revenues from improved employment and productivity outcomes. We also note that affordable housing has higher rental rates than social housing and so tenants are not as disadvantaged as those who require social housing.

There are strong links between stable, quality housing and improved health and justice outcomes, which (if realised) lead to reduced service expenditure. However these benefits are accrued to state governments rather than the Commonwealth. The role of SII in promoting innovation across agency boundaries may be effective here, for example addressing complex needs across housing, employment and education, rather than a single intervention in isolation.

4.4 Financial inclusion

Financial inclusion - overall findings

Financial inclusion (access to financial services, support and advice) is a key prerequisite for economic participation and productivity.

There are numerous and well established examples of Community Development Financial Institutions (CDFIs) in the UK, US and Canada, as well as DSS’ current CDFI pilot. Evaluations consistently found that CDFIs address market failure by assisting individuals and enterprises in disadvantaged areas to access capital at affordable rates and providing useful advice on understanding and managing finances, but struggled to measure outcomes, impact and value-for-money achieved by the overall CDFI sector. Long term self-sustainability was also difficult to achieve with low economies of scale and higher operational costs.

We note that DSS has already started to explore the potential benefits of CDFIs with its recent funding round for three CDFIs (funding is to be combined with private sources of loan capital). The results of this program should contribute to the developing evidence base around what works and what does not in an Australian operating environment.

Overview of government objectives

A key prerequisite for economic participation and productivity is access to financial services, support and advice, also known as financial inclusion. Finance enables organisations to start, expand and continue their operations, and supports individuals to manage their income and expenses, save and invest over time. Where this access is unavailable it results in unmet demand and constraints to economic activity within the community, as well as impaired social outcomes.

The Commonwealth Government is responsible for the fostering and regulation of Australia’s financial services system so that it supports economic growth and meets the needs of Australians. One component of this in recent years has been the piloting of grant funding for CDFIs to address the financial service needs of disadvantaged communities. A new funding round was commenced in 2015 with the requirement that CDFIs also have a private source of loan capital.125

Areas of unmet demand or market failure

Financial exclusion tends to occur for individuals who have low income levels and/or poor credit history, and for small enterprises with low profitability and no assets against which to secure loans. NAB and the Centre for Social Impact estimated that around 17% of Australians experienced “full” or “severe” levels

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125 Financial Wellbeing and Capability Community Development Financial Institutions – Microenterprise Development: Funding Round Summary, Australian Government Department of Social Services, June 2015
of financial exclusion in 2014, particularly young people, indigenous communities, individuals from a non-English speaking background and low income earners\textsuperscript{126}.

### Potential application of SII in Australia

As discussed in section 3.2.2, CDFIs (including credit unions and microenterprise development funds) have addressed financial exclusion in overseas jurisdictions for several decades but are not common in Australia. Issues with limited economies of scale and high operational costs are key factors behind this. We note that DSS has already started to explore the potential benefits of CDFIs with its recent funding round for three CDFIs (funding is to be combined with private sources of loan capital). The results of this program should contribute to the developing evidence base around what works and what does not in an Australian operating environment.

### 4.5 Aged care

#### Aged care - overall findings

The primary objective of aged care services for Commonwealth Government (including home, community and residential care) is to improve the quality of life for older Australians. To that end, the Government funds a range of care service providers and programs.

There is limited evidence of use of SII mechanisms in delivery of aged care services in Australia or overseas: to date this has not been a focus area. One exception is the Newquay Pathfinder program in the UK\textsuperscript{127}, a PBR mechanism that brought voluntary, health and care services together in order to keep older people out of hospital and living independently with evidence showing improved health outcomes for participants over the evaluation period.

The Commonwealth Government is in the process of making significant\textsuperscript{128} changes to the funding and delivery of aged care services, both residential and in the community. The move to consumer directed care (CDC) may increase the opportunity for SII to form part of the overall funding landscape. In addition, Productivity Commission reports have identified specific areas and cohorts with unmet demand as a result of controls on the number of financed places\textsuperscript{129}; these could potentially benefit from a SII approach.

Examples of how SII might be used include:

- Funding for innovative approaches to improve service efficiency and quality
- Scaling and expanding local program delivery in areas with identified unmet need (e.g. Indigenous and disadvantaged areas, regional and rural areas with issues around low economies of scale)
- Infrastructure development for residential and day facilities, drawing on the analogous use of SII mechanisms in the context of social and affordable housing

#### Overview of government objectives

The primary objective of aged care services for Government (including home, community and residential care) is to improve the quality of life for older Australians. To that end, the Government funds a range of care services providers and programs. The hope of these programs is to improve independence and mental stability, maintain connectivity or social contact with family and friends and to provide relief from deterioration in physical health.

In addition to funding aged pension benefits for eligible older Australians, the Commonwealth Government funds a number of programs including:

\textsuperscript{126} Eight Years on the Fringe: What has it meant to be severely or fully financially excluded in Australia?, A Centre for Social Impact Report for National Australia Bank, March 2015


\textsuperscript{129} Productivity Commission Inquiry Report No.53, Caring for Older Australians, 28 June 2011
Commonwealth Home Support Programme – provides entry-level home support for older people who need assistance with living independently at home.\textsuperscript{130}

Residential care - provides a range of care options and accommodation for older people who are unable to continue living independently in their own homes\textsuperscript{131}.

Flexible care - time-limited, goal-oriented and therapy-focused packages of services provided to older people after a hospital stay\textsuperscript{132}.

Viability supplement, provided to providers operating in regional, rural or disadvantaged areas who have low or no profitability to support their operational costs\textsuperscript{133}.

The Home Care Packages Programme provides older people who want to stay at home with access to a range of ongoing personal services, support services and clinical care that help them with their day-to-day activities. The programme is part of the Australian Government’s continuum of care for older people in Australia, providing services between the Commonwealth Home Support Programme and residential aged care\textsuperscript{134}.

Areas of unmet demand or market failure

There have been numerous reports in recent years which describe specific areas or cohorts in Australia where there is unmet demand for home, community and residential care services. At a high level, unmet demand for both community and residential care is most likely to occur in outer regional or rural areas where low population density means that economies of scale and profitability are difficult to achieve without government subsidies. Communities with lower income levels are also more likely to find difficulty in locating affordable residential care.

- The Productivity Commission research paper into aged care trends\textsuperscript{135} indicated that waiting times for residential care were sometimes up to a year for individuals in rural areas.

- The Aged Care Financing Authority (ACFA) 2015 report indicates that while the aged care sector is profitable overall and has a mix of for-profit and not-for-profit providers, a significant proportion of regional and rural providers show a low level of profitability (or are loss-making), relying on the Government’s Viability Supplement to support operational costs and achieve a reasonable return. 39% of regional providers were in the bottom quartile for before-tax earnings compared with 16% of metro providers\textsuperscript{136}.

Potential application of SII in Australia

Aged care has not been a major focus of SII activity to date. In Australia the aged care sector generally appears to be profitable and/or self-sustaining with most for-profit and non-profit providers able to sustain their operations on current government and private funding arrangements\textsuperscript{137}. It is likely that potential cost savings are lower than for preventative and funding intensive services (such as child protection, justice and health).

Overseas jurisdictions also had few instances of SII targeted at aged care compared to other social issues. We found an example of an innovative UK program funded on a PBR basis to deliver better, coordinated community care (Newquay Pathfinder for Integrated Care) which was able to demonstrate a positive reduction in the use of hospital services for program participants (e.g. 30% reduction in non-elective admission costs\textsuperscript{138}).


\textsuperscript{135} Productivity Commission Research Paper, Trends in Aged Care Services: some implications, September 2008

\textsuperscript{136} Third report on the Funding and Financing of the Aged Care Sector, Department of Social Services, J July 2015

\textsuperscript{137} Third report on the Funding and Financing of the Aged Care Sector, Department of Social Services, J July 2015

We consider that SII capital could assist in:

► Increasing the capacity of aged care providers working in areas with shortages or with low income communities by providing growth capital to increase the scale of their operations. In some instances, residential providers may be able to achieve greater scale economies by increasing the number of facilities they own or manage, streamlining administrative activities and extending their purchasing power. This could take the form of funding from SII funds to local community providers.

► Increasing the capability of providers to service complex and special needs groups, which may reduce or delay acute and chronic health care costs incurred in more expensive settings. (We note that health services are delivered through a complex division of responsibilities and funding between the Commonwealth, state / territory governments and the private sector, so co-operation between jurisdictions would be required if payments were to be based on expected cost savings. Refer to section 4.6 for further discussion on SII and health funding.)

► Funding the expansion of innovative solutions or service delivery models which can demonstrate some evidence of success and are expected to lead to increased service quality, improved health outcomes for participants and cost savings for aged care and health. For example, the Newquay program demonstrated some success with reducing hospital entries; a similar program could also target an increase in the time period over which participants use community care (rather than more intensive residential care).

4.6 Health

Health - overall findings

Commonwealth, state and territory governments and private providers share responsibility for delivering health services across Australia through a complex division of responsibilities for service delivery and funding between the Commonwealth, state / territory governments and the private sector. There are several areas within the health system that exhibit indicators of unmet demand or issues with service delivery (for example, poor coordination of service planning and delivery across health care, social and other sectors; future service shortages from an ageing population and issues with access to care in some regional and rural areas; and chronic disease and lower lifetime health outcomes for Indigenous persons, disadvantaged persons and those with specialised health needs).

We found several UK and US health service schemes funded on a payment by results basis; we also identified Australian examples of the use of co-operatives in primary health care to solve issues of market failure around the availability of community health services (for example, Victoria's Westgate Health Co-op and ACT’s National Health Co-op). There were no examples of SIBs or SII fund investments with documented results in health, but we observe that healthcare is one of the priority areas for state government SII activity\(^\text{139}\) and so this may develop in the future.

We believe that there are potential benefits that may be gained from a detailed investigation of the performance and applicability of SII mechanisms to health services within the Australian context. Possible focus areas could include addressing specific geographic shortages by expanding place-based community social enterprises, or scaling up existing programs or innovations that can demonstrate success with co-ordinated (and more effective) service delivery, addressing specific health issues or servicing Indigenous and disadvantaged communities.

A particular challenge with health SII at the Commonwealth level is that any realised benefits from primary health care SII are likely to be spread across both Commonwealth and state / territory governments and potentially private providers, limiting the payments that Commonwealth Government


can provide without broader participation by other sector participants (e.g. state / territory governments). For SII mechanisms with an element of payment by results (SiBS and PbR schemes), it is likely that cost effectiveness will only be possible if the investment incorporates some mechanism by which payments are funded by both governments.

Overview of government objectives

Health is a fundamental aspect of a person’s wellbeing and health service delivery to improve population health outcomes is a key responsibility of governments. There is an extensive body of research which details the significant influence that social and economic factors (such as socioeconomic status and income levels) have on health outcomes. The reverse sometimes also applies – a person’s life expectancy has direct bearing on the lifetime economic contribution they can make, and poor physical or mental health often leads to higher risk of unemployment and poorer social outcomes.

The responsibility for health services delivery is split between Commonwealth, state and territory governments and private providers in what is sometimes seen as a complex and fragmented arrangement. The diagram below illustrates the split of service delivery responsibilities and funding across different sector participants.

Source: Australian Institute of Health and Welfare, “Australia’s health system 2014”[140]

Areas of unmet demand or market failure

The Department of Health's National Primary Health Care Strategic Framework\(^{141}\) describes high level areas which have unmet demand or issues with service delivery, in particular:

- Poor coordination of service planning and delivery within the sector and with other health care, social and welfare sectors.
- Future service shortages from an ageing population, chronic disease and workforce pressures.
- Lower lifetime health outcomes for Indigenous persons, regional and rural populations, disadvantaged persons and those with specialised health needs (such as disabilities or mental health issues).

Potential application of SII in Australia

The involvement of social enterprises and impact investing in health services varies considerably by country and reflects the differing levels of government involvement in health services. In the UK, which has a system relatively similar to Australia’s, the government National Health Service (NHS) traditionally dominated service delivery and so social enterprises have tended to focus on specific health or infrastructure needs (e.g. early intervention mental health programs, property for community clinics).

However UK social enterprises are increasingly involved in health services. A number of large Community Interest Companies (CICs, a type of social enterprise) have been established to deliver place-based community care following the closure of NHS’ Primary Care Trusts. These organisations compete with for-profit providers and trusts for government contracts. Social Enterprise UK\(^{142}\) estimates that around a third of its members operate in health and social care. (We note that these appear to be largely funded by government contracts so may not quite fit the definition of SII.)

In the US, government funding/subsidies for health services are much more limited\(^{143}\). Social enterprises often focus on increasing access and affordability of primary health care, as well as prevention and early intervention programs.

Examples of SII in health which demonstrated positive benefits to individuals and government include:

- Shared Pathfinder – UK – funded by SII fund Big Society Capital – innovative program that co-ordinates home and community care to be provided by carers in their own home – results to date indicate benefits around improved health and social wellbeing, reduced hospital entries (and associated cost\(^{144}\) savings).
- The National Health Co-op, ACT was established to meet unmet demand for affordable GPs and primary health services in Belconnen, ACT, using funding from the community, state and Commonwealth governments and business investors. The co-op has expanded over 10 years to five locations with\(^{145}\) 23 GPs and other allied health care providers. Over 20,000 people are registered as patients. Melbourne's Westgate Health Co-op is another example of a well-established and successful health services co-operative.
- An example of a PbR arising from the US is the Blue Cross Blue Shield Alternative Quality Contract\(^{146}\), which realised savings of 2% in the first year and 10% over 4 years compared to non-

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\(^{144}\) Scaling up Solutions to Social Care: The potential impact of social investment on social care for older people, LE London Economics, October 2014


participants. Quality of care scores were also increased over the national average over the first 4 years. It should be noted that additional scrutiny would be required when considering adapting a PbR mechanism to an SII context.

The experience from international jurisdictions and the range of areas for improvement in Australian health service delivery suggest that the application of SII to Australian health services could be investigated in more detail. We observe that regulatory, health and social systems overseas differ significantly from Australia’s and so it is difficult to extrapolate overseas results to an Australian context. This reinforces the need for careful application of best practice SII design principles.

Specific areas for improvement that could be investigated for SII applicability include addressing specific geographic shortages by expanding place-based community social enterprises, or scaling up existing programs or innovations that can demonstrate success with co-ordinated (and more effective) service delivery, addressing specific health issues or servicing Indigenous and disadvantaged communities.

A particular challenge with health SII at the Commonwealth level is that any realised benefits from primary health care SII are likely to be spread across both Commonwealth and state / territory governments and potentially private providers, limiting the payments that Commonwealth Government can provide without broader participation by other sector participants (e.g. state / territory governments). For SII mechanisms with an element of payment by results (SIBs and PbR schemes), it is likely that cost-effectiveness will only be possible if the investment incorporates some mechanism by which payments are funded by both levels of government.

4.7 Disability services

Disability services - overall findings

The disability services landscape in Australia is in the process of wholesale transformation as the National Disability Insurance Scheme (NDIS) rolls out.

We found limited evidence of the use of SII mechanisms specifically in the field of disability services. However, possible areas of disability services that might be amenable to a SII construct include:

- Expansion of service capacity
- Support greater service co-ordination
- Capital for affordable, suitable housing
- Specific employment services

The linkages and parallels to broader delivery of employment and housing services should be recognised. The move to personal budgets present opportunities for innovative collective solutions to be developed to local pockets of need, and SII may have a role to play in that innovation, providing working capital in particular.

Overview of government objectives

The Commonwealth Government offers programs to support people with disabilities, their families and carers which range from general care to mentorship, assistance with managing the impact of mental illness on their lives, respite support and support for those severely affected by mental illness.

Programs include:

- The National Disability Insurance Scheme (NDIS)147
- Outside School Hours Care for Teenagers with Disability148

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Areas of unmet demand or market failure

The rollout of the NDIS aims to resolve any issues of unmet need identified in the Productivity Commission’s original report\(^{144}\) that led to the establishment of the scheme.

Demand will continue to grow however as:

- Population and demographic projections indicate that those with ongoing needs for assistance in self-care, mobility or communication are growing in number and ageing\(^{154}\).
- There are high numbers of people with disabilities using services for the homeless, and their need for support services is recorded by service providers\(^{144}\).

There may still be pockets of difficulty meeting unmet demand in regional and remote areas. The NDIS and the provision of personal budgets most likely creates the scope for innovative service delivery to evolve.

Potential application of SII in Australia

It is likely that the rollout of NDIS will need time to settle first prior to injection of further SII in this sector. However, it is worth consideration of potential avenues through which SII could make significant future impacts, particularly in the context of the transformed landscape for delivery of services that the NDIS will establish.

There may be a greater role for SII to expand home and community care options, and so reduce hospital or primary health care costs.

Possible areas that might be amenable to a SII construct could include:

- Expansion of service capacity
- Support greater service co-ordination
- Capital for affordable, suitable housing
- Specific employment services


\(^{154}\) “Productivity Commission Inquiry Report No.54, Disability Care and Support, 31 July 2011”
One potential application based on overseas experience could be a program similar to the Shared Lives Incubator in the UK. This used a loan from Big Society Capital to provide home and community based care arrangements for vulnerable persons with support needs, via trained host carers (“homeshare”). The SII is helping to trial an innovative pilot scheme to scale the program (which has previously struggled to scale). From the 2015 report, 12,000 clients were assisted by 8,000 carers with estimated cash savings of up to £26k p.a. per person with learning difficulties (£8k for those with mental health issues). There were additional social and economic benefits such as improved wellbeing, lower future health costs etc. although these were not quantified\textsuperscript{155}.

Alternatively, a payment by results mechanism could be used to provide intellectual disability services similar to the National Health Service in England which introduced a pilot program in 2013\textsuperscript{156}. A submission from National Disability Services in 2011\textsuperscript{157} also considered the use of a social impact bond to meet the unmet needs of the community of persons with disability.

4.8 Quantification of potential benefit to Commonwealth Government programs from a social impact investment approach

A review of the evidence of realised benefits for Government relating to all three forms of SII suggests that there are several areas of government policy where a SII approach may be useful for Australian governments to more efficiently and effectively achieve their objectives. Our focus has been on cost savings to the Commonwealth Government but we have also identified broader benefits in specific policy areas.

In order to quantify the benefits to Government for the policy areas discussed above we have proceeded as follows:

- Identified the high level scope of current relevant spending on this policy area.
- Identified a basis for sample quantification, using the strict criteria of SII programs that have realised benefits.
- Discussed the potential benefit to the Government in Australia and determined whether this can be quantified or not and to what extent.

In general the publically available data regarding SII mechanisms was not of sufficient detail to allow a full estimation of benefits, thus this quantification remains high level and provides a broad indication of areas where Government programs may benefit from an SII approach. This high level analysis has not considered other sources of evidence for service efficacy, such as program evaluations or clinical trials, except to the extent they may have supported the development of particular programs.

The quantification suggests that there is evidence for the potential to realise benefits using SII mechanisms to reach unmet need, provide working and infrastructure capital and develop innovative program delivery in a way that enhances overall achievement of Government objectives.

This high level analysis has not considered ongoing savings that may be realised over a person's lifetime and has not directly considered benefits that may be realised in broader domains than financial savings, such as economic and social benefits, although these are likely.

It is important to note that regulatory, health and social systems overseas differ significantly from Australia's and so it is difficult to extrapolate overseas results to an Australian context. Detailed investigation into the applicability of SII to Australian Commonwealth Government services would be required to better understand the potential impact of SII in the Australian context.

We also note that Commonwealth and state governments share responsibilities in key areas such as education and health and so any cost savings would need to be split between the two. If justifying SII on

\textsuperscript{155} Investing in Shared Lives, Social Finance, July 2013
\textsuperscript{156} Alex Nicholls, Emma Tomkinson, The Peterborough Pilot Social Impact Bond, University of Oxford, 2013
\textsuperscript{157} Senate Economics Reference Committee’s Inquiry into Finance for the Not-for-Profit Sector, National Disability Services, September 2011
the basis of cost savings then Commonwealth and state governments may need to jointly develop such an investment.

Early education and child care

There is currently an unmet need for early education and child care with only 82% of children enrolled against a target of 95% including in relation to vulnerable children. Over $400 million is currently allocated for two years under the National Partnership Agreement on Early Childhood Education (ECE).

There are a range of SII mechanisms which focus on avoiding remedial education by providing early education and child care services, two of which have evidence of realised benefits (Utah SIB and US Head Start) however it is not possible to quantify the benefit to Government. It is anticipated that the program would improve lifetime outcomes for individuals in relation to education and employment, and welfare dependency. These outcomes are linked to medium term cost savings to Government especially in relation to primary and secondary education, however it is important to note that these benefits will accrue to state governments.

<table>
<thead>
<tr>
<th>Aspects of most potential for SII mechanisms</th>
<th>Scope of relevant Commonwealth spending</th>
<th>Basis for quantification - using SII programs with realised benefits</th>
<th>Potential benefit (estimated on example from &quot;Basis for quantification&quot; where possible)</th>
</tr>
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</table>
| Unmet need: In particular there exists an access gap for vulnerable and disadvantaged children, with only 86% having access against a benchmark of 95% and an availability gap for all children, with only 82% enrolled for at least 15 hours per week against a benchmark of 95% | Appro. $406m: Contributions under the National Partnership Agreement on Early Childhood Education focused on ensuring that all children have access to a quality ECE program: $406m across 2014/15 and 2015/16 budgets | Example - Lower education cost: • Utah SIB – goal was avoidance of remedial education due to the benefit of increased access • US Head Start – outcomes focussed rather than SII | Not quantifiable on information available: Improved lifetime outcomes from access to quality ECE are well documented. Medium term savings in primary and secondary education accrue to States. Longer term savings in welfare likely but not quantified by existing SII.
Conclusion: Evidence for potential benefit is strong but cannot be quantified on the basis of existing SII evidence alone. |

Employment, further education and training

Government currently spends over $10 billion on Newstart and $1 billion on Youth Allowance. The research shows that social enterprises can improve the education and employment outcomes for young people and older adults. In particular the UK programs that target young people that are not in employment, education and training (NEETs) generate considerable short and long term benefits. Social enterprises need access to finance for working capital for start-up and expansion. It is not possible to quantify these benefits, however evidence from the New Zealand Investment Approach suggests that support for welfare claimants can realise benefits in the shorter and longer term.

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Innovative program delivery: Provision of working capital to social enterprises</td>
<td>Approx. $11.4bn: Newstart $10.4bn and Youth Allowance $1bn in the 2015/16 Budget</td>
<td>Example - Lower future welfare payments: We found extensive evidence on effective SII mechanisms in this field, but available public information does not</td>
<td>Not quantifiable on information available: The New Zealand Investment approach illustrates how short and medium terms savings might be realised, for example a reduction of 5% in number of claimants in receipt of a particular grant led to a reduction of 8.5% in annual benefit outgo (compared to</td>
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160 Portfolio Budgets Statements 2015-16 – Budget Related Paper No 1.15A – Social Services Portfolio p76.
### Aspects of most potential for SII mechanisms

<table>
<thead>
<tr>
<th>Unmet need: Infrastructure capital</th>
<th>Scope of relevant Commonwealth spending</th>
<th>Basis for quantification - using SII programs with realised benefits</th>
<th>Potential benefit (estimated on example from “Basis for quantification” where possible)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;$10.6bn: Commonwealth Rent Assistance is expected to reach $4.4bn in the 2015/16 fiscal year 164</td>
<td>Unclear - early stages: We found extensive evidence of successful SII mechanisms developing housing or aiding people into housing. These initiatives are all at early to medium stages, so long term outcomes cannot yet be measured.</td>
<td>Not quantifiable on information available: Foundational needs met Longer term savings on homelessness, welfare</td>
<td></td>
</tr>
<tr>
<td>The National Affordable Housing Agreement is ongoing. It provided $6.2b from 2009 to 2013 165</td>
<td>Conclusion: Evidence for potential benefit is strong but cannot be quantified on the basis of existing SII evidence alone.</td>
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</table>

### Social and affordable housing

The Commonwealth Government currently spends over $4 billion on Commonwealth Rental Assistance and over $6 billion was provided to state and territory governments under the National Affordable Housing Agreement in its first five years (2009-2013).

There is a strong body of evidence of the efficacy of SII in relation to social and affordable housing including supporting tenants. Whilst there is some evidence on which to quantify benefits it is insufficient to quantify benefits for the Commonwealth Government. It is expected that cost savings will relate to long term savings on homelessness services, reduced dependency on welfare and increase in contribution though tax, and reduced demand for services for individuals and families.

### Aged care

There is significant unmet need relating to aged care especially in regional and rural areas. In 2013/14 Government spent almost $15 billion on aged care services. The introduction of consumer directed care will change the way that some social organisations will access funding. The research identified a range of SII activities related to aged care which generate cost savings in terms of avoidance of health costs. The Newquay Pathfinder for Integrated Care reduced hospital admissions for non-elective treatment by 30% and acute admissions relating to long term conditions by 40%. In addition, housing which facilitates independent living or provides supported accommodation could delay entry into residential care. These outcomes will generate significant cost savings and therefore realised benefits for Government however it has not been possible to quantify them.

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162 Estimating the life-time cost of NEET, Coles et al, University of York, 2010
163 Work and Income 2013 Benefit System Performance Report for the year ended 30 June 2013, Rabaul and Judd, NZ Ministry of Social Development, 2014
164 Department of Social Services Annual Report 2014-15 p48
### Financial inclusion

It is estimated that 17% of Australians experience some form of financial exclusion. Currently only 6% of people who are eligible for No Interest Loans and need access to credit are being served. Evidence from Community Development Financial Institutions suggests that individuals achieve improvements in short and long term outcomes if they have access to appropriate and affordable credit. It is not possible to quantify the benefits to the Commonwealth Government but it is anticipated that there will be cost savings in relation to homelessness services, health and income support, and avoidance of costs in relation to Emergency Relief.

<table>
<thead>
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</thead>
<tbody>
<tr>
<td>Unmet need: Access to financial products for those unable to access mainstream financial services</td>
<td>Approx. $100m: In the 2015/16 Budget total funding for the Financial Wellbeing and Capability activity is $100m</td>
<td>Outputs measured: CDFIs have proved successful although generally measured on the basis of key outputs rather than medium to longer term outcomes</td>
<td>Not quantifiable on information available: Foundational needs met Longer term savings on homelessness, welfare</td>
</tr>
<tr>
<td>Unmet need likely to be much larger (estimated 17% of Australians, see body of this report)</td>
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<td></td>
<td>Conclusion: Evidence for potential benefit is strong but cannot be quantified on the basis of existing SII evidence alone</td>
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</table>

### Health services

There are a wide range of health services where there is unmet need and potential for innovative program delivery or replication of proven programs. Government currently spends over $100 billion across health services delivered by Commonwealth government, state/territory governments and private providers.

Whilst not a SII, the US Alternative Quality Contract has demonstrated significant benefits in terms of cost savings over the short and medium term with 2% realised savings in the first year and 10% over 4 years. We observe, however, that there are considerable differences between the Australian and US

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167 Portfolio Budgets Statements 2015-16 – Budget Related Paper No 1.15A – Social Services Portfolio p 92
health systems which may limit the relevance of this example. Given this limited evidence basis we were not able to quantify the potential benefits to the Commonwealth Government.

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<thead>
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</tr>
</thead>
<tbody>
<tr>
<td>Unmet need: Arises from poor co-ordination of service planning and delivery, future service shortages and lower lifetime health outcomes for certain groups in the population as identified in National Primary Health Care Strategic Framework.</td>
<td>Approx. $104.8bn: Total Government expenditure on health was $104.8bn in 2013/14 across Commonwealth and state jurisdictions.</td>
<td>Example – Cost savings from use of less expensive providers: One example with evidence of realised benefits, while not financed via an SII mechanism, was the US Alternative Quality Contract. This is a PbO mechanism operating across primary care, specialists and hospitals. It realised savings of 2% in the first year and 10% over 4 years compared to non-participants. Quality was also improved.</td>
<td>Not quantifiable on information available: Savings may be possible from appropriate adaptation of this or other examples as evidence base develops.</td>
</tr>
</tbody>
</table>

Conclusion: Evidence for potential benefit exists but cannot be quantified on the basis of existing SII evidence alone.

Disability services

The level of unmet need in relation to disability services was identified by the Productivity Commission and has led to the implementation of the National Disability Insurance Scheme (NDIS). The NDIS will not only increase the level of funding available for people with disabilities but also change how service providers are funded. Currently $30 billion is allocated to disability services. There are a range of SII programs achieving outcomes which deliver cost savings to Government. For example, the UK’s Shared Lives program generates significant outcomes for people with learning difficulties which generates savings of GBP 26,000 per person. If this program could be replicated in Australia this would generate cost savings in the region of $250 million.

<table>
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</thead>
<tbody>
<tr>
<td>Innovative program delivery: (noting unmet need should be dealt with principally via transition to NDIS)</td>
<td>Approx. $30bn: Approximately $30bn in total assistance to people with disability in the 2015/16 Budget.</td>
<td>Example – lower cost of operation: The Shared Lives program in the UK provides strong evidence of cash savings achieved while scaling an innovative program: GBP 26k per annum for those with learning difficulties.</td>
<td>In the order of $250m: Improved outcomes, including health and employment outcomes.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>If annual savings of this order could be realised in the same proportion as already achieved in the UK, annual cash savings (excluding longer term outcomes) would be of the order of $250m, noting the barriers of translating successful international programs to local settings.</td>
</tr>
<tr>
<td></td>
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<td></td>
<td>Conclusion: Evidence for potential benefit is strong.</td>
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</table>

This high level analysis has not considered other sources of evidence for service efficacy, such as program evaluations or clinical trials, except to the extent they may have supported the development of particular programs discussed above. Examples of these sources include:

- Washington State Institute for Public Policy Benefit-Cost Results, which cover a number of domains including Health Care and Public Health and Prevention which are of particular relevance.

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to the Government (many other focus areas, such as Justice and Child Welfare, are of more relevance to the States).

► Cochrane Reviews\(^{173}\), systematic reviews of primary research in human health care and health policy, and are internationally recognised as the highest standard in evidence-based health care resources.

► Social Programs that Work\(^{174}\), sponsored by the Coalition for Evidence-Based Policy, which identifies successful interventions and classes the quality of evidence for them (Top Tier or Near Top Tier) across a range of domains including employment and welfare, mental health, post-secondary education as well as a number of others of more relevance to the States.

► What Works Clearinghouse\(^{175}\) for evidence-based policy in education, managed by the Institute of Education Sciences on behalf of the US Department of Education.

► What Works\(^{176}\), a moderated virtual library of evidenced interventions that aim to support children's speech, language and communication maintained by academics, the Royal College of Speech and Language Therapists and The Communication Trust.

These high quality data sources should continue to complement evidence available to local providers or Government departments in supporting development of programs that may be effectively delivered using an SII mechanism.

### 4.9 Considerations for government

A number of recent Government initiated reviews including the McClure Welfare Review (McClure), the Financial System Inquiry (FSI) and Harper Competition Review (HCR) have recognised the potential of SII and identified a number of actions for government. A Senate Inquiry in 2011 identified barriers and actions to develop a “capital market for the not-for-profit sector in Australia”\(^{177}\). The G8 Social Impact Investment Taskforce and Impact Investing Australia (IIA) have also formulated recommendations to help develop SII. Further we discussed considerations for government in the course of our stakeholder interviews. This section provides potential considerations for government in addition to those identified for specific policy areas, informed by our stakeholder interviews, our desktop research and our examination of the information available on benefits to be realised.

In general terms governments can:

► Help raise the profile of SII and highlight best practice.

► Provide appropriate guidance to contribute to a common understanding.

► Remove barriers for all stakeholders.

► Encourage the use of SII mechanisms when commissioning services especially where they offer innovation and value for money.

The following considerations for government have been identified:

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\(^{173}\) “What is Cochrane evidence and how can it help you?” Cochrane website, [http://www.cochrane.org/what-is-cochrane-evidence](http://www.cochrane.org/what-is-cochrane-evidence), accessed 5 November 2015


\(^{176}\) “What Works?” The Communication Trust website, [http://www.thecommunicationtrust.org.uk/projects/what-works.aspx](http://www.thecommunicationtrust.org.uk/projects/what-works.aspx), accessed 5 November 2015

\(^{177}\) Investing for good: the development of a capital market for the not-for-profit sector in Australia, Economic References Committee, The Australian Senate, November 2011
Developing the role of the Commonwealth Government in supporting the development of the SII market

The reviews above have called for overarching actions that focus on facilitating development of the SII market. Progress in the UK and globally has been facilitated by a taskforce and this still remains a priority for the leaders and managers of not-for-profit organisations. In a recent survey they ranked this as the second highest priority for government\(^{178}\). Over recent years IIA, as a private initiative, has to a large extent fulfilled a comparable role to the UK's Social Investment Taskforce, also a private initiative.

There may be merit in providing a forum for Commonwealth and state government agencies to coordinate their interests and consider how best to support the development of the SII sector. There are options for possible structures, such that this forum could then provide a point of contact for engaging with the SII community in terms of investors, service providers and intermediaries.

The terms of reference for such a forum could also include an exploration of how the Commonwealth and state governments can best work together.

“Now, why it works often better in some other jurisdictions than just have one level of Government is [because] you can capture all of those benefits and wrap them up into the bond. Now that hasn't stopped the New South Wales state government or the South Australian government doing some really innovative things in this space but it does limit when the Commonwealth and the states and territories aren’t working together on these types of interventions and I think there’s scope to deal with that.”\(^{179}\)

The Hon Scott Morrison MP, Federal Member for Cook, Treasurer

The Commonwealth Government could also consider:

- Establishing a funding mechanism to support state government SII activities including top up reward payments where cost savings and other benefits accrue to them. This funding could be targeted at policy priorities such as Indigenous communities, employment pathways for vulnerable people, homelessness, family violence, and social cohesion.

- Identifying SII champions across different portfolios to signal Government's recognition of the importance of SII, to ensure opportunities to use a SII approach are not missed, and to provide points of contact for state governments that are developing propositions in relation to their interests.

- Commissioning a series of case studies to raise the profile of SII and highlight best practice. DSS has previously used this approach to promote Public Service Mutuals with four case studies which now feature on the Get Mutual website development by the Business Council of Co-operatives and Mutuals.

Establishment of a Social Impact Fund and an Investment Readiness Fund

The perceived success of Big Society Capital in the UK\(^{180}\) has prompted consideration of the potential for a dedicated fund of wholesale capital to develop the SII market. IIA has proposed the establishment of an ‘Australian Social Impact Fund’ with $350 million in seed capital to stimulate impact investing activity and encourage new market participants.

Although there appears to be a healthy appetite from investors to satisfy the current level of demand for SII opportunities, the establishment of such a fund would require time to develop and implement. Government could assess the merits of establishing such a wholesale fund, how it might be implemented in Australia and over what duration.

\(^{178}\) In the recent Pro Bono Australia State of the Sector Survey 2015, 1,100 leaders and managers of not-for-profit organisations ranked a Social Finance Task Force the second highest priority initiative for government. Mechanisms to expand and strengthen partnerships between business and not-for-profit organisations was highest ranked and a national public campaign to promote philanthropy / charitable and workplace giving was ranked third.


IIA has also proposed the creation of a $10-20 million investment readiness ‘resource fund’ to equip social enterprises and not-for-profit organisations with the advice and capacity building they need to secure SII. Findings from the UK highlight the importance of funds in improving investment readiness due to the additional set of skills SII requires. For example, NAB, in partnership with IIA and the Difference Incubator, has established an Investment Readiness Fund with $1 million which will be allocated to social enterprises to secure professional advice. NSW has also established an Expert Advice Exchange to facilitate access to pro bono professional services.

Although it is early days for both initiatives, the Commonwealth Government could assess the demand for such services and the potential to stimulate SII activity and create a larger and sustained pipeline. If there is demand and evidenced potential, then the Commonwealth Government could either establish its own Investment Readiness Fund or allocate funds to be managed by an existing provider.

Investment approach and commissioning services

To date most SII mechanisms have been relatively small in scale, focused on achieving outcomes over 2 or 3 years and aim to synchronise reward payments when cost savings are being realised. There is support for government to use the “investment approach” to welfare reform in the McClure welfare review which DSS is now in the process of developing. Where the Commonwealth Government implements interventions that create long term outcomes and cost savings, there may be opportunities to use an SII approach where there is a need for external capital.

Similarly in relation to the use of an SII approach when Payment by Results / Outcome mechanisms are used, there may be an increased appetite for service providers to participate if long term arrangements allow them to access capital to strengthen their organisations. For example, the current jobactive contracts are for a ten year period but service providers needed working capital to enhance their services and may also experience cashflow problems before receiving reward payments. Our desk research didn’t find evidence of the use of SII to address these problems.

Using SII in relation to the investment approach or PbR may create larger and longer term SII propositions which may interest institutional investors. It may also aid in providing the rigour necessary for the attribution of effect and reward across the complex areas of need serviced by multiple portfolios and/or levels of government.

Access to data and evidence and building capabilities

The tasks of collating data and evidence, and quantifying, monitoring and evaluating performance on a comprehensive and consistent basis are considerable but essential for the development and growth of an efficient and effective SII market. The challenge is magnified given the fragmented nature of the social sector and variation in capacity and capability. SII requires the collation of and access to data and evidence in terms of relevant service user cohorts, program evaluations, and costing and pricing of outcomes. These data are needed by all stakeholders - government, proponents and investors.

DSS, as they develop their investment approach, are building relevant service user data sets. This, alongside the Commonwealth Government’s broader open data initiative\textsuperscript{181}, will increasingly provide access to SII proponents. A number of agencies including The Washington State Policy Institute assemble data and evidence on the efficacy of programs in terms of benefits and costs. The UK has invested in developing a unit cost database to help costing and pricing. The Productivity Commission\textsuperscript{182} called for the establishment of a Centre for Community Service Effectiveness to act a as repository for program evaluations.

The Commonwealth Government could co-ordinate and/or otherwise continue to support initiatives to develop and make available data and evidence that support SII. This could include infrastructure such as data repositories and guidance in order to enable like-for-like reporting that could be aggregated into a system view.

\textsuperscript{181} Public Sector Data Management Project, more information can be found at https://www.dpmc.gov.au/pmc/about-pmc/core-priorities/public-data-branch-within-dpmc/public-sector-data-management-project

\textsuperscript{182} Contribution of the Not-for-Profit sector, Research Report, Productivity Commission, Canberra, 2010
In addition to developing data and evidence, it is important to develop capabilities in outcomes measurement, evaluation, benefit cost analysis, data analysis and modelling, which the Commonwealth Government could support.

Social impact investing and innovation

A range of actions have been proposed which focus on encouraging innovation in funding social service delivery (FSI, McClure and HCR). McClure stated that SIBs offer “a chance to inspire innovation and transfer some of the risk from Government while developing interventions based on sound research for challenging, wicked policy areas”.

The parameters for using SII to promote innovation are different from scaling up existing proven programs. Government could consider establishing a social innovation fund such as the USA’s SIF to test and learn from programs, and then scale up proven programs through payment by results mechanisms.

This innovation fund could work in parallel with the funding mechanism referred to above to help Commonwealth and state governments collaborate.

Guidance for investors and policy reform

A range of actions have been identified to provide guidance for investors and to remove barriers. The FSI called for the development of guidance to superannuation trustees on the appropriateness of impact investment and the IIA has called for clarification of duties for superannuation & philanthropic trustees, and for reform to classify certain private ancillary funds as a ‘sophisticated’ or ‘professional’ investor.

Government could consider supporting existing initiatives to implement these changes.

Promoting and supporting social enterprise

A range of actions have been proposed to support the development of social enterprises and specifically support the continuing evolution of intermediaries and the emerging SII ecosystem. It is not clear how best the Commonwealth Government can support social enterprise, therefore the functioning of the current ecosystem could be reviewed and benchmarked against the UK and the USA to provide this missing evidence.

Potential legal structures and taxation implications

Legal forms for social enterprises such as CICs in the UK and BCorp in the US are described in Appendix A. We have considered whether the development of an alternative legal form could contribute to removing barriers to social investment in Australia. In Appendix A.4 we review potential amendments to the Corporations Act suggested by the Social Enterprise Legal Models Working Group (LMWG) and suggest a possible modified version.

We further consulted with our tax subject matter resources on the issue of appropriate and effective tax treatments for SII in all its forms.

It was noted that the UK Social Impact Tax Relief (SITR) mechanism would be appropriate to adapt to Australian situation for instruments, funds and social enterprises. It could work in conjunction with associated legal entity such as the SCEC outlined above or another CIC-like entity.

It may be considered preferable to work with existing tax structures rather than create something new and SITR meets this condition. In general if new structures are created there tend to be significant challenges in limiting the risk of abuse of the concessional tax treatment, such that benefits may be substantially watered down.
5. Case studies

5.1 Goodstart Early Learning: demonstrating the benefits of financial innovation

ABC Learning was an Australian company founded in 1988 which grew to become the world’s largest provider of early education services with close to 1,000 centres across Australia. However it went into voluntary liquidation in 2008. The Goodstart Early Learning syndicate was established in 2009 in order to acquire ABC Learning through a competitive tendering process using debt finance provided by Government and social investors, with the aim of turning it into a social enterprise and delivering quality child care services to all its families. The consortium consisted of The Benevolent Society, Mission Australia, the Brotherhood of St Laurence and Social Ventures Australia (SVA). In December 2009 Goodstart won the bid to take over 650 ABC Learning centres from receivers McGrath Nicol. The receiver’s alternative options were a private sector bid from Archer Capital or the Australian Government “nationalising” ABC Learning.\(^{183}\)

In 2010, when the deal was closed, Goodstart became the largest social enterprise in Australia\(^{184}\). In 2015 they employ 13,500 staff and provide services to 71,500 children through 643 centres (there have been closures for operational and infrastructure reasons, as well as investment in new centres)\(^{185}\). Operating surpluses are reinvested in quality and social inclusion initiatives\(^{186}\).

Structuring the deal\(^{187}\)

Goodstart’s major challenge was raising the necessary capital to acquire ABC Learning. Goodstart was established as a not-for-profit (NFP) company limited by guarantee as the syndicate felt that this structure was more aligned with their social impact objectives and would afford them relative tax advantages compared to a for profit company. However the downside of this decision was that any capital raised would have to be 100% debt funded.

Their solution used a range of different financial instruments to enable them to attract enough capital. The final cash investment mix included senior bank debt provided by NAB, a layer of secured Government debt, a layer of social capital notes and finally members’ subordinated notes, provided by all four members. The two types of members’ notes carried relatively high risk (ranking below the senior debt, below the Government loan and below the social capital notes) and GoodStart had no obligation to pay. The social capital notes were proposed to more than 150 high net worth individuals, philanthropists and foundations and 41 agreed to invest. The social capital notes also carried relatively high risk and GoodStart had no obligation to pay.

The deal was managed by Michael Traill, CEO of SVA, and supported by a number of advisors; Gilbert + Tobin, KPMG, CHAMP, Koczkar and Parker & Partners, who provided their services with low or no upfront fees and success fees in line with commercial rates. The following schematic by SVA summarises the deal structure:

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\(^{184}\) ibid


\(^{186}\) ibid

Financial and social innovation

The consortium saw potential for social impact given that research indicates that early education for disadvantaged children is one of the most beneficial early intervention strategies\(^{188}\). They also recognised that ABC Learning was a financially viable distressed asset. Goodstart employed a layered investment approach which accommodated the different risk appetites and investment tolerances of the parties involved. Goodstart also innovated new financial instruments, such as social capital notes, and the unusual deeply subordinated notes that were designed to meet the particular needs of investors by providing both a social and financial return, both of which were defined and tailored in some detail.\(^{189}\)

Commercial, financial and social returns

As of 2015, all external debt including the social capital notes have been repaid\(^{190}\). Goodstart’s three strategic goals are oriented around quality, inclusion and financial stability\(^{191}\). In 2015 they reported\(^{192}\):

<table>
<thead>
<tr>
<th>Quality</th>
<th>78% of centres assessed under NQS as Meeting or Exceeding 830 Early Childhood Teachers, with 32% reduction in turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inclusion</td>
<td>100% increase in inclusion investment to $1.6m 1,200 children with additional needs</td>
</tr>
<tr>
<td>Stability</td>
<td>Statutory net surplus of $15.9m ($22.0m in 2014) Significant capital investment, increasing from $23m to $35m from 2014 to 2015</td>
</tr>
</tbody>
</table>

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\(^{188}\) Investing in the Early Years - A National Early Childhood Development Strategy, Council of Australian Governments, 2 July 2009


\(^{191}\) Ibid

5.2 STREAT: Seeking commercial sustainability through equity social finance

STREAT was the first social enterprise to scale with equity investment in Australia\(^{193}\). It was established in 2009 as a Not-for-Profit (NFP) that provides disadvantaged young men and women in Melbourne with the opportunity to build sustainable, long-term careers in hospitality. STREAT provides jobs for at-risk youth aged 16-24, alongside six months of industry training, and well-being and social support programs. The range of issues faced by these trainees included homelessness (98%), drug and alcohol (69%), mental health issues (53%) and family violence (48%). The program aims to empower its trainees to progress into full time employment or further training in retail or hospitality elsewhere after completion of the program.\(^{194}\)

STREAT’s start-up finance was provided from overseas philanthropic sources\(^{195}\) and it has since received substantial financial and in-kind support from a mix of philanthropic, government and corporate sources.

**Business expansion\(^{196}\)**

In 2011 STREAT developed plans to scale their business to reach 100 youth per annum by 2015. At that stage the business was not self-sustaining and relied mainly on grants, with only 20% of the operating budget funded from business trading income. In 2012 STREAT was approached by another social enterprise, the Social Roasting Company (SRC), and they negotiated a deal for STREAT to acquire two cafés and a coffee roasting business for $300,000. The deal would double STREAT’s capacity for social impact.

STREAT’s capital raising activity had previously been limited to community fundraising, grants or debt. They felt that the first two options would take too long and require a significant amount of effort, while the third option required STREAT to adhere to a strict repayment schedule which presented risk if the business surplus did not match financial return expectations.

Following consultations with investment advisors, STREAT decided to raise capital using equity as this would share the risks of business failure between STREAT and its investors. Under this strategy:

- STREAT established a for-profit entity (STREAT Enterprises) that would own the purchased businesses.
- STREAT sold 50% of the equity in STREAT Enterprises to raise sufficient funds to cover the entire purchase while retaining control of the enterprise.
- Expected investor financial returns were in the range of 7 to 12% over the first three years.

Source: STREAT’s acquisition of the Social Roasting Company’s café’s and roasting business, “A case study in social finance”, N.D., Social Ventures Australia, p27.

**Diagram:**

STREAT found four investors that had an interest in ‘blended value’ - for-profit organisations that aim to have a substantial social impact. These were the McKinnon Family Foundation, Donkey Wheel, Small Giants, and SRC’s previous owner, Fair Business.

\(^{193}\) Creating a fork in the road (the first five years), N.D., STREAT, [https://www.streat.com.au/sites/default/files/streat_the_first_5_years_final_reduced.pdf](https://www.streat.com.au/sites/default/files/streat_the_first_5_years_final_reduced.pdf)


\(^{196}\) This paragraph sourced from ibid.
Business outlook
Since its first expansion STREAT has increased its operations to five cafes, a coffee roaster business, a catering company and the ongoing construction of a $2.5m training facility. The organisation has increased its level of self-sufficiency with business trading income as a proportion of total income growing to around 70% in 2014. Five years after inception (2014) they reported:

► 321 young people have participated in STREAT programs
► 80% success in youth obtaining a job or further training
► 95% success in improving housing stability
► 60% + youth retention in programs

STREAT’s goal is to be financially sustainable and cover all ‘business as usual’ costs from business trading income. Unanticipated delays in the facility expansion have slowed their growth rate but STREAT anticipates that their business income will represent 74% of their income in FY15, 80% in FY16, and 93% in FY17.

The graph below shows the breakdown of sources of funding for STREAT, including charitable income and grants from government and other sources.

Source: Creating a fork in the road (the first five years), N.D., STREAT, p16

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197 Creating a fork in the road (the first five years), N.D., STREAT, https://www.streat.com.au/sites/default/files/streat_the_first_5_years_final_reduced.pdf
198 ibid
5.3 Rikers Island Social Impact Bond: failed program but successful mechanism

In 2012, the City of New York (NYC) launched the nation's first social impact bond to fund the Adolescent Behavioral Learning Experience (ABLE) program, a large-scale initiative serving 16 to 18 year old youth detained in New York City's Rikers Island jail. The ABLE program aimed to break the cycles of re-incarceration for adolescents in the jail using Moral Reconation Therapy (MRT), an evidence-based intervention that focuses on improving social skills, personal responsibility, and decision making\textsuperscript{199}. The bond was structured such that the funder would receive a return on its investment at 3 and 5 years if the number of recidivism bed days were reduced by at least 10 percent. Goldman Sachs provided a $7.2 million loan to non-profit MDRC from its Social Impact Fund, which oversaw the project. Bloomberg Philanthropies, the personal charity of former Mayor Michael Bloomberg, provided a $6 million loan guarantee\textsuperscript{200}.

According to the Vera Institute\textsuperscript{199}, 87 percent of the 16 to 18 year olds who entered the jail during 2013 and were held for more than six days attended at least one ABLE session, and 44 percent reached a programmatic milestone found in prior studies to be associated with positive outcomes.

Although the program was intended to run for four years it was terminated early as it failed to meet its intended recidivism targets. As a result Goldman Sachs lost $1.2 million and Bloomberg lost their grant funding, but government did not incur any financial loss because of the program's failure to achieve the breakeven level of performance\textsuperscript{200}.

Failed program but successful social impact mechanism

Although the program itself was not a success, the Rikers Island SIB shows how social impact bonds can lead to better and more effective achievement of social outcomes by government where used effectively:

► Reduced risk to government through transfer of risk to investors. The use of outcomes-based decision making meant that NYC's tight public budget could be used to good effect, as it was only required to pay for program success.

► Increased transparency, accountability and evidence base, and funding for innovative programs. The service provider was able to use the bond structure to obtain robust evidence of whether the previously successful MRT therapy could be applied to youth recidivism in Rikers Island. Although it was not successful, by measuring and monitoring the program outcomes NYC and the service provider have a better understanding of the service being delivered, what worked well and what needed improving. The service provider now has more information on which to adjust, adapt and innovate its service model to better match the need of that particular cohort.

5.4 Newpin Social Benefit Bond: successful social investment

UnitingCare Burnside's Newpin program is an intensive 12 to 18 month child protection and parent education therapeutic program in NSW, aimed at creating safe family environments to restore children in care to their families or prevent children from entering care. The program is evidence based and draws on a similar program from the UK.

The Newpin Social Benefit Bond (SBB) was launched in July 2013 to fund the maintenance and expansion of the program. The SBB consists of a $7 million, 7.25 year performance-based contract between the NSW Government and UnitingCare\textsuperscript{201}. Payments are made if the 12 month restoration rate for a cohort is greater than the state average (the baseline) in line with a pre-defined schedule. The


\textsuperscript{200} What we learned from the nation’s first social impact bond, James Anderson and Andrea Phillips, 2 July 2015, Huffington Post, \url{http://www.huffingtonpost.com/james-anderson/what-we-learned-from-the-_1_b_7710272.html?ir=Australia}

Bond was over-subscribed and attracted almost 60 private investors with a minimum investment of $50,000, including high net worth individuals, institutional, trusts and foundations\(^{202}\).

**Newpin service delivery process**

![Diagram showing service delivery process]


**Successful program to date**

The Newpin SBB demonstrates how effective use of SII mechanisms can lead to improved social outcomes for government and community along with financial return for investors:

- Addressed unmet need and increased capacity and capability for service providers.
  - In the first two years of the SBB more than 55% of the children in the program were successfully restored to their families over a 12 month period. The program has now successfully restored a total of 66 children to their families and delivered an 8.9%pa financial return to investors, based upon a cumulative restoration rate for the first two years of the SBB of 61.6%. The program has also supported an additional 35 at-risk families in preventing their children from entering out-of-home care.\(^{203}\)

- These positive results have allowed the program to expand its reach with two new centres opening in Wyong and South West Sydney.\(^{203}\)

- Reduced risk to government through transfer of risk to investors. NSW Government is only required to pay investors if the program is successful (i.e. if restoration rates are higher than the state average).

- Increased transparency, accountability and evidence base, and funding for innovative programs. The Newpin program represents an innovative approach in that it covers multiple service areas and provides support to families both before and after restoration. UnitingCare Burnside is notable for its commitment to performance monitoring and associated research to ensure the program continues to evolve and achieve its targets: outcome measures were adjusted partway through the program to reflect interim learnings, and the implementation evaluation report stated that the SBB program had “created a more structured and transparent basis for action” and “the introduction of greater data capture and reporting is forming a stronger basis for staff reflecting on and improving practice, and adding to the evidence base for future program enhancement”\(^{204}\).

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\(^{204}\) Evaluation of the Newpin SBB Program – Implementation report, Urbis, September 2014
Appendix A Background material

A.1 Definitions and classifications

A.1.1 Definition of social impact investing

The Organisation for Economic Co-operation and Development defines social impact investing as “the provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial, return”\(^{205}\).

SII engages a range of stakeholders including:

► Governments as primary agents for commissioning services to address social needs and support other stakeholders that address social needs

► Not-for-profit organisations and social enterprises as providers of these services

► Investors that provide finance for these services and organisations

► Intermediaries that seek to develop and support SII propositions

A.1.2 Classification of social impact investments

There are three dominant forms of SII:

1. SII mechanisms where government has commissioned services using an SII approach. These mechanisms combine the interests and incentives of some or all of the key stakeholders listed above. Social impact bonds are the most prominent example. Payment by results schemes and the investment approach to government services such as welfare and housing are variants.

2. SII funds and other intermediaries which supply finance to social sector organisations. These act as intermediaries between social sector organisations and social impact investors (including both government and private sectors).

3. Social enterprises that are created by or utilise SII to provide start-up, growth or operating finance.

A.1.2.1 Social impact investing mechanisms from government commissioning

SII mechanisms are primarily a product of government commissioning of services that use an SII approach. The most popular version of these mechanisms is the Social Impact Bond or Social Benefit Bond that link government agencies, service providers, social impact investors, and service users through a series of contractual obligations (refer to the figure below).

SIBs are structured on the basis of a contract where a funder (usually government) agrees to pay a service provider if they achieve agreed outcomes. The payment for achieving outcomes must exceed the anticipated cost of delivering the service for the service provider to participate. The pricing of the outcomes must also offer benefits for government through achieving better outcomes and value for money, particularly in terms of realising future cost savings or avoided costs. The pricing of outcomes will also include a premium that reflects the volatility in costs and the level of uncertainty in achieving the agreed outcomes. This premium will incentivise service providers and investors to engage.

The service provider may require external capital from an investor to deliver the services at the necessary scale and quality. The service provider may also share the risk and rewards of the outcomes contract with investors providing external capital. The use of private capital to cover up front and operating costs reduces the short term call on government funds. Government is liable for future cash flows to providers and investors only if outcomes are achieved and when cost savings are realised. However, in recognition of the level of financial risk, government may agree to underwrite or guarantee a proportion of the cost of delivering the service by making payments to the service provider, meaning that only a proportion of the costs are at risk.

Given the complexity of these contractual relationships and lack of precedents, SIBs are typically developed through a joint development phase where contractual terms are negotiated and agreed. For the early SIBs, these negotiations took considerably longer than traditional service procurement processes. In the future information sharing, increasing availability of knowledge resources including model contracts, and learning may combine to speed up the process.

The key elements of a joint development phase include:

► Definitions for the desired outcome, target cohort and scale of this cohort.
► The level of outcomes to be achieved.
The duration of the service and the time to achieve and measure outcomes.

The pricing of outcomes in comparison to the cost of delivering the service including use of any external capital.

Level of transfer of financial risk specifically in terms of the level of guarantee or underwriting provided by government.

The level of investor appetite to participate.

The method for measuring outcomes including use of control or comparator groups, quasi-experimental, historical precedent or administrative data; and use of an independent agency to measure or verify the measurement of outcomes.

SII mechanisms including SIBs are flexible and can accommodate the interests of multiple stakeholders through the formulation of propositions that optimise the incentives of these stakeholders.

SIBs in the market today vary in size from a few hundred thousand dollars to twenty five million dollars with contract durations ranging from two years to ten years. The first SIB relating to Peterborough Prison was developed by an intermediary and presented to the UK Government through an informal unsolicited bid process. This SIB was developed on the basis of a Social Return on Investment (SROI) study which modelled levels of costs and benefits including the level of social returns and cost savings for Government.

More recent SIBs, such as the two operating in NSW (UnitingCare’s Newpin program and Benevolent Society’s Resilient Families Program), are the product of formal procurement processes including use of an initial procurement phase to select proponents that will participate in a joint development phase. The nature and specificity of these procurement processes have become more sophisticated with an increasing amount of preparatory work undertaken by government and presented in the call to market; this has led to a clearer statement of the outcomes government is wishing to procure and less work for proponents.

Other mechanisms that link to SII include:

- **Payment by results (PbR) schemes**

  Governments in Australia and overseas are increasingly looking to use PbR contracts or outcomes based contracts to procure social services, with the aim of improving the effectiveness and efficiency of government investing.

  This contracting approach offers a mechanism whereby some or all of the payments to service providers are contingent on the provider achieving the results or outcomes set out in the contract. The intention is that this will increase the focus of government agencies and service providers on achieving positive client outcomes rather than focusing on processes and outputs that are easier to measure, but time-consuming to report and more importantly may not necessarily lead to longer term impact.

  In Australia and the UK, PbR contracts have historically been applied to employment services, where results in terms of work placements for 13 and 26 weeks for those finding it difficult to enter the workforce can be clearly measured and linked to outcomes in a relatively short time. Australian Commonwealth and state government agencies are now looking at (or in the process of) transitioning their existing grants or block contracts to an outcomes based framework across other areas, such as disability services, out-of-home care and child and family services.

  There are also locally-focussed PbR mechanisms in the UK for specific programs in child and family services, including Troubled Families, and complex health services.

  PbR contracts need to be underpinned by robust performance information systems. Payments are linked to outcomes achieved and the number of interventions the provider begins (in the case of

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207 National Evaluation of the Troubled Families Programme, UK Department of Communities and Local Government July 2014

Department of Social Services for the Prime Minister’s Community Business Partnership
Social impact investing research
attachment fees). Therefore, in order to ensure that correct payments are made, commissioners need accurate, reliable and timely information on the numbers of outcomes achieved and participants attached to programs. In cases where independent sources of data are unavailable, commissioners will be reliant on provider data – however this presents potential conflicts of interest and must be accounted for carefully.

► Investment approach

In 2012, New Zealand’s government adopted what is commonly termed as an “investment approach” to managing its welfare system and informing welfare reform. This approach involves the use of an actuarial analysis to measure the future liability associated with benefits paid under the welfare system. The liability is used as a proxy for assessing people’s risk of long term benefit dependency. Amongst other purposes, the welfare valuation is used as a tool to assist with:

► Assessing the effectiveness of investments made to improve employment outcomes and reduce benefit dependency (taking into account both short and longer term impacts).

► Identifying areas for attention or potential target cohorts for programs / services.

The New Zealand government is now investigating the extension of this approach to other social service areas, such as housing and justice. In Australia, the Commonwealth Government is now developing its own investment model and state governments are also exploring its feasibility at a state level.

A.1.2.2 SII intermediaries which supply finance to social sector organisations

SII funds

SII funds supply finance in the form of debt and equity to social sector organisations to help them achieve social outcomes and be financially sustainable. These funds are necessary where there is market failure in terms of existing sources of finance not supporting these organisations and activities or there is a limited amount of finance available.

Investments can take the form of debt (usually a loan to a social enterprise), equity (part investment in a social impact fund which itself provides loans or invests in SIIIs) or quasi-equity.

At a high level, the key objectives of SII funds are to:

► Scale up social enterprises to increase their impact by improving access to finance and support (i.e. increasing capacity and capability), with a specific focus on priority areas for impact.

► Facilitate the development of the broader impact investment market nationally.

► Deliver some degree of financial return to investors.

The desk research identified over fifty independent funds dedicated to SII, as well as many institutional investors that have funds which can be used for SII and Socially Responsible Investing, and high net worth individuals that make SIIIs. The Global Impact Investing Network (GIIN) have over 300 funds and products registered on their ImpactBase which hold over $25 billion capital. In addition, a GIIN and J. P. Morgan survey of impact investors captured data on almost 150 impact investors that committed over US$10 billion to impact investment in 2014.

A number of SII funds have been established in the UK, US and Europe with the highest profile player being UK’s Big Society Capital, a £600m wholesale SII fund launched in 2012. BSC is a wholesale fund that invests in Social Investment Finance Intermediaries (SIFIs) which provide appropriate and

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208 Actuarial Valuation of the Benefits System for Working – age Adults, Ministry of Social Development & The Treasury, 30 June 2012


210 Big Society Capital; GHK 2013 Growing the Social Investment Market: The landscape and economic impact; GIIN www.thegiin.org/impact-investing/need-to-know/#s8; J . P. Morgan, the GIIN Eyes on the Horizon: The Impact Investor Survey

affordable finance to social sector organisations In the US, the $750m Social Innovation Fund212 awards grants to intermediaries and organisations to help develop an evidence base for the efficacy of their programs and has established a payment for outcomes fund to help organisations scale up and access SII213.

A small number of such funds have been operating for many years, including: REDF in the USA which invests in social enterprises that provide jobs214; Bridge Ventures in the UK which manages funds for social entrepreneurs and SIBs215; and Triodos Bank which manages a global fund that invests in pioneer sustainable enterprises relating to energy efficiency, renewable energy, arts and culture and sustainable food and agriculture216.

SII funds vary in size, ranging from less than $10m up to over $100m217. Several focus on specific social outcomes or geographies, and use a portfolio approach to balance financial risk and financial and social returns.

Australia set up its first SII fund initiative in 2010, the Social Enterprise Development and Investment Fund (SEDF)216, with three intermediary SII fund managers (Foresters Community Finance, Social Enterprise Finance Australia (SEFA)219 and Social Ventures Australia (SVA)220) being selected to manage SEDIF funds in 2011 and 2012. The Government provided $20 million of seed funding which has been matched by private investors. SEDIF fund managers operate at arms’ length from government and provide SII finance in the form of loans and equity investments ranging from less than $100,000 to over $1 million. The total pool of funding across the three funds is now $41.1 million. As at 30 September 2015, $19.2 million in investments had been approved to assist social enterprises through 72 loans221. An evaluation of the SEDIF initiative is due for completion in June 2016.

Most of these funds recognise that organisations may require capacity building in order to be ready for SII; however, whilst they are able to provide expertise and resources to help organisations access finance, they do not undertake the most substantive capacity building that some social purpose organisations need to be investment-ready. A number of specialist funds have therefore been created specifically to provide grants that help organisations build capacity and be investment ready. In 2012, the UK Government established the Investment and Contract Readiness Fund (ICRF)222 with GBP 10 million to provide grants to social organisations to help them access professional advice. In Australia, in 2015, the National Australia Bank (NAB) in partnership with Impact Investment Australia and the Difference Incubator established the Impact Investment Readiness Fund with $1 million to provide grants to help social organisations access professional advice. These investment readiness funds set targets for helping social organisations secure SII223.

Other finance intermediaries

There are a number of other types of funds which seek to co-create commercial and social returns but are not always considered as SII. Their aim is to provide financial services, support and advice for communities in regional, rural and disadvantaged areas where mainstream banking services are

217 Examples of relatively small SII funds include Australia’s Foresters Fund ($5m at FY14) and UK’s Affordable Homes Rental Fund (£2.5m at FY15); larger SII funds include US’ Social Innovation Fund and UK’s Real Lettings Property Fund (c. £57m as at FY15)
221 Information provided by the Department of Employment
222 UK’s Investment and Contract Readiness Fund http://www.beinvestmentready.org.uk (December 2015)
unavailable or withheld, resulting in unmet demand and constraints to economic activity. The longer term goal is to help clients overcome obstacles to their participation in mainstream banking.

► Community Development Financial Institutions

In the USA, Canada and the UK, Community Development Financial Institutions (CDFIs) are numerous and long established. CDFIs address market failure by assisting individuals and enterprises in disadvantaged areas to access capital at affordable rates. CDFIs also provide useful advice on understanding and managing finances and addressing financial needs (e.g. repaying debt). In the UK the bulk of CDFI loans are to businesses, which provides the basis for generating a financial return alongside existing social returns. CDFIs' capital typically comes from a range of government, philanthropic and private sources. In the USA capital is accumulated via a legislated levy on banks through the Community Reinvestment Act. Australia has explored the potential for using CDFIs with pilots and associated policy analysis.

CDFIs and other place-based SII Funds may play a key role in supporting the existing and widening use of Collective Impact approaches, including in Indigenous communities.

► Microfinance

Australia has a strong record of developing microfinance initiatives albeit with a strong element of philanthropic support rather than SII. NAB and Good Shepherd Microfinance (GSM), with the support of DSS, have a substantial program to address financial exclusion for individuals.

The No Interest Loan Scheme (NILS) is based on a pool of capital provided by NAB, loan application and management services provided by Good Shepherd Microfinance, and financial support provided by DSS. Given there is no interest charged, NILS does not satisfy the SII criteria that both financial and social returns should be targeted. NAB also operates a low interest loan program, StepUP, for clients who are financially excluded; some elements of StepUP are operated by GSM and the program also supported by DSS. StepUP does generate a small financial return to NAB, but this return does not reflect the risk and opportunity costs. An evaluation of NILS in 2014 estimated that the program was only satisfying 6% of the demand for credit by people eligible for it.

NAB also runs a microenterprise loan scheme and support program that provides unsecured loans of up to $20,000 on a low interest basis. Eligibility is based on microenterprises that are receiving support from partner government and not-for-profit agencies. Indigenous Business Australia, which is a government agency, is one of NAB's partners; it operates a number of funds using its own capital and provides debt and equity for Indigenous owned businesses.

A.1.2.3 Social enterprises that are created by or utilise SII

Social enterprises are organisations that seek to co-create commercial and social value by selling goods and services which either directly or indirectly create social value. According to Social Enterprise UK, an organisation can be categorised as a social enterprise if it:

► has a clear social mission
► generates the majority of its income its trading activities (i.e. is commercially viable)
► reinvests the majority of its profits in pursuit of its mission
► is majority controlled in the interests of its mission

Social enterprises can adopt a range of legal structures and business models. Some use the company limited by shares business legal structure, some the company limited by guarantee not-for-profit legal structure, whilst others use a co-operative legal structure. In some jurisdictions such as the UK a...
dedicated legal structure has been established for social enterprise, the CIC which allows the social enterprise to use both debt and equity finance, and has an asset lock that ensure the organisations assets and resources are applied for community benefit\textsuperscript{229}.

Social enterprises can also declare their status as a Benefit Corporation (BCorp) by completing a certification process operated by B Lab which assesses their social and environmental performance, accountability and transparency. There are over 1,400 Certified BCorps in over forty countries with over fifty BCorps based in Australia\textsuperscript{230}.

The scale, nature and impact of social enterprises in Australia is currently being explored through the Finding Australia’s Social Enterprise Sector (FASES) research initiative which is being conducted by Swinburne University in partnership with Social Traders, a social enterprise intermediary. Research in 2010 estimated that there were 20,000 social enterprises in Australia with the number increasing by 7% per annum over the previous five years\textsuperscript{231}.

In the UK, Government statistics identify 70,000 social enterprises which contribute GBP 24 billion to the economy and employ nearly a million people. Over one in ten are small with annual turnovers less than GBP 10,000 and over one in six are large and have annual turnovers exceeding GBP 1 million. Social enterprises are well represented in education and child care, business and financial support, employment services, retail, social care, culture and leisure, health care, environment, creative industries and housing\textsuperscript{232}. Accessing finance is generally recognised as a barrier to start-up and growth\textsuperscript{233}, with many social enterprises partially reliant on grant funding.

Many SII mechanisms and funds engage social enterprises as well as not-for-profit organisations (NFPs). Some social enterprises may have used SII to help them start up and operate their enterprise. Two examples, Good Start Early Learning and STREAT are presented as case studies in Section 5.

A.2 The potential benefits of social impact investing to the Commonwealth Government

The desk research and interviews identified the following potential benefits to the Commonwealth Government of using SII:

- Improve value for money – reducing demand for services and achieve cost savings.
- Risk transfer to investors – transfer of financial and performance risk to investors and service providers.
- Stimulate innovation – service providers and investors take the lead on and bear the costs of innovation to deliver better outcomes and value for money.
- Scale up innovation to meet unmet need – external capital to scale up proven programs to satisfy unmet needs and/or achieve better value for money.
- Alternative source of working capital – alternative source of working capital for service providers to help them improve the capacity and capability.
- Collaboration – consortia provide access to private finance and share risk, and can encourage innovation, leverage expertise, improve asset utilisation, and provide integrated long term management.
- Leverage resources for priority areas – incentivise propositions that leverage external resources for Government policy priority areas and geographies.


Leverage resources of social enterprises – some social enterprises are aligned with Government policy goals and offer an alternative delivery mechanism which may deliver better outcomes and use diversified revenue streams which subsidise their activities and may reduce the call on Government funds.

Informs policy development and implementation – the requirement to systematically measure the costs and benefits means that Government can monitor performance and amend policy settings and commissioning parameters.

Improve quality of services – helps service providers focus on outcomes and clients and deliver higher quality Government funded services.

Increased transparency, accountability and performance – measurement and reporting requirements may increase transparency and accountability of Government funded services and improve the performance of service providers.

A.3 Stakeholder interests in SII
The level of interest in and use of SII has increased over the past ten years both globally and in Australia in response to the persistence of wicked social problems, the perceived ineffectiveness of existing approaches, and insufficiency of government and philanthropic funding.

Why are government agencies interested in SII?

Government agencies are actively seeking to allocate resources to those services that deliver the best possible social outcomes and offer value for money. This has led to a focus on services where there is evidence of social outcomes being achieved, and an emphasis on prevention, early intervention and breaking cycles of disadvantage. For government this may mean more effective allocation of funding and achievement of outcomes over time associated with cost savings or avoided costs.

Many government agencies are therefore moving away from procuring service inputs and activities and towards a commissioning approach which places greater emphasis on outcomes and performance measurement. The use of outcomes contracting or payment by outcomes (PbO) mechanisms means government pays for the achievement of pre-agreed outcomes and not the provision of services. SII has emerged as an important element when designing a PbO mechanism.

The potential benefits for outcomes based contracting and payment by outcomes include:

- Incentivising service providers to achieve the agreed outcomes and be more client focused, which not only delivers better outcomes for clients but higher levels of client satisfaction.
- Focusing on the outcomes and not how the service is delivered encourages providers to innovate and optimise how they deliver their services.
- Achieving realisable cost savings for government within a specified period.
- Deferring part or all of government expenditure until the outcomes are achieved and
- Transferring some or all of the risk that outcomes are not achieved to service providers.

What is the link between Payment by Outcomes and SII?

The use of PbO means that there is a delay between incurring costs and receiving payment. This may cause cashflow problems for service providers which can be addressed in two ways. Firstly, government can pay for a proportion of the cost of providing the service and reserving the remainder as a reward when the outcomes are achieved. Secondly, the service provider can use external cashflow or bridging

234 Outcomes are defined as positive long term changes for individuals, organisations and communities including in relation to physical and mental wellbeing, education and employment, sustainability and resilience of organisations and communities.

235 Payment by outcomes is not new. Employment services in Australia including the current jobactive program have for several decades included payments to providers for achieving job placements for 13 and 26 weeks.
finance. The need for external finance will increase if the service provider needs working capital to buy new equipment, move to larger or more appropriate premises and recruit more staff and/or more highly qualified staff. SII is a potential source of cashflow / bridging finance and working capital and in a number of jurisdictions including Australia dedicated SII funds have been established for this purpose.

The use of PbO also involves risk, where the achievement of outcomes and therefore receipt of payments is not guaranteed. This risk may be perceived as too high by the service provider and undermine the financial sustainability of the organisation, which can be addressed in two ways. Firstly, government can reduce the proportion of the payment which is related to achieving the agreed outcomes with the majority of the payment guaranteed. Secondly, the service provider can seek to share the risk through use of external finance where repayment is also linked to achieving the agreed outcomes.

For mainstream services, government is able to access capital on favourable terms from traditional financial markets; however over recent decades, it has developed a range of Public Private Partnerships (PPPs) to procure infrastructure developments that “deliver improved services and better value for money primarily through appropriate risk transfer, encouraging innovation, leveraging expertise, use of consortia to mobilise interested stakeholders, greater asset utilisation and an integrated whole-of-life management, underpinned by private financing.” There are therefore similarities between the use of PPP’s for infrastructure and SII, which can help government frame SII, however the parameters for SII may be very different to those used for PPPs now. Government and PPP proponents are now able to accurately cost the delivery of infrastructure and have a good understanding of risk which means that they are able to price delivery and secure investors.

What is the link between SII and the “Investment Approach”?

The New Zealand Government has developed what is known as the “investment approach” to welfare reform. It is based on an actuarial valuation that estimates the lifetime liability to the welfare system of different types of people and the potential to intervene early to prevent long-term welfare dependency or break the cycle of long term welfare dependency. Government’s investment in these interventions is expected to achieve long term cost savings. Other governments including Australia are also developing an investment approach.

Whilst SII has yet to be considered as part of the investment approach, there are strong comparisons with payment by outcomes mechanisms especially in terms of incentivising service providers and sharing risk, noting that the investment approach is based on a life time or at least a longer term period for the realisation of Government cost savings.

Why do service providers need external finance and SII?

Existing service providers need finance in order to operate and expand their organisation, whilst new providers need finance to set up. Traditionally NFPs would seek finance from philanthropic sources in the form of grants however there is a limit to the amount of philanthropic capital that is available. In addition, significant transaction costs can be incurred in terms of time to prepare applications, and philanthropic capital may not be available for some considerable time.

NFPs, as defined by being a company limited by guarantee and not shares, are not able to raise external finance through equity and are therefore limited to debt finance. However, social enterprises which are companies limited by shares do have the potential to raise both equity and debit finance.

Many NFPs and social enterprises have weak balance sheets and therefore do not have internal sources of finance; this also means that they find it difficult to access appropriate and affordable finance which typically requires collateral. Many NFP boards are also risk-averse and reluctant to take on debt. Therefore, NFPs are generally under-capitalised with low utilisation of debt finance.

In the UK, a tax incentive for investors has been introduced to stimulate SII. Although the initial Social Investment Tax Relief legislation was limited in size and eligibility it serves to reduce the cost of capital for social enterprises and applies to both debt finance and equity.

What are the motivations of social investors?

The primary focus, and for some the sole purpose, of commercial investors is to maximise the financial return on use of their capital, which means that they do not have to pay regard to social and environmental impact. However, over the past decade investors have sought to mitigate negative social and environmental impact which has led to recognition of Responsible Investing.

Responsible Investing can be implemented by investors by screening out investments which constitute a risk in terms of negative social and environmental impact. It can also be implemented by investors identifying investments that enhance social and environmental impact. Social impact investors are those that seek investments that generate both financial and social returns.

The weight that individual social impact investors place on each of these twin objectives varies. Some are looking for commercial market rates of return based on the level of risk, others may be open to risk that the investment may not generate a commercial return and their capital not be guaranteed, and some are happy with a below market rate of return and risk of losing some or all of their capital.

Social impact investors which place the greatest weight on social return include philanthropic institutions and high net worth philanthropists, which can rationalise the downside risk in terms of losing capital as being the equivalent of providing grants and donations. Philanthropic institutions may categorise these as Program Related Investments (PRI) where they are aligned to the institution’s mission. Some philanthropic social impact investors may make an investment alongside a grant or donation.

Institutional and sophisticated investors will seek to assess both the upside and downside risk associated with the expected levels of financial and social returns. The balance will be influenced by the investor’s motivation to address a social need. These investors may seek to ring fence this risk by have a dedicated fund for SII and allocate the bulk of their investment capital through a Responsible Investment process. Institutional investors typically focus on large investment opportunities including long term investment opportunities. Currently, the size of many SII opportunities is too small to attract institutional investors. In addition, some institutional investors like liquidity which most SII opportunities are not able to offer. A new breed of SII propositions may be needed to access significant amounts of capital from institutional investors.

Retail investors can also participate in SII through: hypothecating their capital held by institutional investors such as superannuation funds to dedicated SII funds; and also through the use of crowdfunding platforms that offer returns or equity investments. Crowdfunding is acknowledged as being particularly relevant to financing small and medium sized enterprises including community and social enterprises.

Why is evidence of outcomes being achieved so important?

All forms of SII place an emphasis on the measurement of outcomes and the evidence of the efficacy of programs to achieve outcomes. Traditional methods of funding used by government and philanthropic agencies such as contracts and grants have been based on the delivery of activities and achievement of outputs, and not the achievement of outcomes. Historically, this has led to insufficient investment in measuring and evaluating outcomes achieved by services. This is changing, but by definition it takes a number of years to complete a program of outcome measurement and evaluation.

Over the past five years, an increasing number of social organisations have embarked on outcomes measurement by developing outcomes measurement frameworks and implementing methodologies such as Social Return on Investment (SROI) and Results Based Accountability (RBA). SROI and RBA share some common elements including understanding how a program works and then linking the

Social impact investing research

Measurement of inputs, activities, outputs and outcomes together (refer to the figure below). SROI can be used in two modes; retrospective evaluation and formative predictive. Social organisations seeking SII may use an SROI evaluation to demonstrate effectiveness and an SROI prediction for a SII Mechanism such as a social impact bond.

Figure 3: Illustrative theory of change

Research suggests that less than half of social organisations are systematically measuring their social impact and even less linking the creation of financial and social value, however SII stimulates this measurement. The emerging international accounting standard relating to Service Performance Reporting will also stimulate greater measurement of outcomes. Not-for-profit organisations will be required to assemble information on services that have a positive impact on society and relate this to their financial information in order to help users of general purpose financial statements to assess an entity’s performance. There is therefore a need to build capability in measuring social impact for SII and also in preparation for Service Performance reporting.

RBA has been adopted by a number of state Government agencies which has also stimulated outcomes measurement activities. Some government agencies have also established specialist units to develop data sets, and undertake and support program evaluations. In the USA, the Government’s Social Innovation Fund awards grants to intermediaries and organisations to help develop an evidence base for the efficacy of their programs. This is supported by a number of USA charitable foundations that fund and promote evaluation, including the Annie E Casey Foundation.

There are also specialist research centres that are developing methodologies, databases and repositories to support program evaluations and benefit cost analysis for programs such as the Washington State Institute for Public Policy (WSIPP). WSIPP has developed a three-step process to “draw conclusions about what works and what does not to achieve particular outcomes of legislative interest”. This includes a meta-analysis to identify policy options from programs that have evidence of achieving outcomes, the benefit and cost of implementing programs in Washington State including taxpayer and non-taxpayer benefits, and assess the risks of implementing the program. This approach generates a benefit to cost ratio for each program and a probability score that the program will be successful and benefits will exceed costs.

This approach has been used across criminal and juvenile justice, child welfare, education, health care including mental health, substance abuse, and public health and prevention. For example, State and District early childhood education programs have a $4.66 benefit to cost ratio with an 83% chance that the benefits will exceed the costs. This approach also identifies a number of early education programs that have very low or negative benefit to cost ratios and low probabilities of benefits exceeding costs.

The NZ investment approach uses actuarial analysis which also considers the relationship between inputs, outputs, outcomes and benefits; and is used to produce longer term forward estimations of benefits and costs (refer to the figure below).

Figure 4: An Illustrative Actuarial Investment Model

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238 Reporting Service Performance Information, Australian Accounting Standards Board, August 2015
GIIN provides IRIS, a database of metrics to “support transparency, credibility and accountability in impact measurement practice across the impact investing industry”. The goal is to achieve standardisation to allow comparability across SII and includes metrics relating to inputs, activities, outputs and outcomes.

The use of data and evidence in developing SII propositions is essential and requires a set of specialist skills. Whilst social organisations can commission experts or benefit from the pro bono services of experts, social organisations also need to build their own capabilities and capacities in relation to SII especially in relation to measuring social outcomes.

A.4 Potential legal structures

The Social Enterprise Legal Models Working Group (LMWG) - which was originally convened by Centre for Social Impact as part of the “Social Innovation, Entrepreneurship and Enterprise Alliance” (SIEE) - has been operating as a working group chartered to investigate the issue of social enterprise business models/legal structures. Recently the LMWG has been assisting social policy groups including the Prime Minister’s Community Business Partnership with reviewing this issue. A discussion paper on “Legal Structures for Social Enterprise in Australia” has recently been submitted to the Partnership. They have also produced a Final Report that is publically available.

A series of potential amendments to the Corporations Act have been suggested by the LMWG that would resolve the major issues with current legal forms and thus enable social enterprise in a sustainable and effective legal form. These amendments are as follows:

Social and Community Enterprise Companies

Where the constitution of a public or proprietary company specifies that the company is a ‘Social and Community Enterprise Company’ under this Section, the following provisions apply:

Transfer of Assets

242 Based on information provided by the Legal Models Working Group
1. Any transfer of assets from the company must satisfy the following requirements
   a) It must be made at full market value, so that company retains the value of the assets, or
   b) It must be made to another company.
      i. Whose constitution specifies that it is a ‘Social and Community Enterprise Company’.
      ii. Is a registered charity.

Note: Assets may still be used as collateral under this sub-section

Payment of Dividends

2. A company may pay dividends to shareholders.

3. The payment of a dividend is subject to cap of 30 per cent of the company’s distributable profits for that year.

4. The cap in sub-section 3) may be varied by regulation.

Prohibition on Certain Amendments to a Company’s Constitution

5. Where the constitution of a public or proprietary company specifies that the company is a ‘Social and Community Enterprise Company’ under this Section
   a. The clause of its constitution that makes that specification cannot be amended or varied.
   b. Other clauses in the constitution must be consistent with this section or they are void.

Following review by our legal subject matter resources, we suggest the following modified version of the amendments, may be considered for the Corporations Act 2001 (Cth). Notes and comments are denoted in [square brackets]. Specific legal advice should be obtained in respect of this.

Social and Community Enterprise Companies (SCEC)

Insert a new definition in Section 9 as “Social and Community Enterprise Company” as follows:
“Social and Community Enterprise Company” means a public or proprietary company that:
   a. Is required to comply with sections 117(o) and 136(7) of this Act.
   b. Is registered under the [Australian Charities and Not-for-profits Commission Act 2012].

[Noting that presumably all SCECs would be registered with ACNC. If the ACNC is to be the primary regulator of SCECs this legislation should also be reviewed.]

Amend section 117:
(1) By replacing the “.” at the end of paragraph “m” with a “;”
(2) By inserting a new paragraph “(o)” as follows:
“(o) for a Social and Community Enterprise Company – following:
   (i) That it is a Social and Community Enterprise Company
   (ii) Its Australian Charities and Not-for-profits Commission registration number.”

Amend section 136 “Constitution of a company” as follows:
(1) By replacing the “.” at the end of sub-section “(6)” with a “;”
(2) By inserting a new sub-section “(7)” as follows:
“(7) The constitution of a Social and Community Enterprise Company must:
   a) Specify that it is a Social and Community Enterprise Company
   b) Specify what the purpose is of the company
   c) Include the following restrictions on the transfer of assets of the Company:
      “A Transfer of Assets
      A.1) Any transfer of assets from the company must satisfy the following requirements:
a) Subject to where the company is under External Administration under Chapter 5 of this Act, it must be made at full market value, so that company retains the value of the assets; or
b) It must be made to another body corporate [Noting that a charity may or may not be a company]
   i. Whose constitution specifies that it is a ‘Social and Community Enterprise Company’, or
   ii. Is a registered charity
Note: Assets may still be used as collateral under this sub-section”
d) state that the payment of dividends of the company will be applied as follows:
   “B. Payment of Dividends
   B.2) The payment of a dividend is subject to cap of 30 per cent of the company’s distributable profits for that year
   B.3) The cap in rule B.2 may be varied by regulation [by the Australian Charities and Not-for-profits Commission or by ASIC, to be determined] “
e) State that any proceeds arising from the winding up of the company, after payment of the company’s liabilities will be applied as follows:
   “C. Proceeds on a winding up
   C.1 If the company is wound up, the proceeds after payment of the company’s liabilities must be made another body corporate [Noting that a charity may or may not be a company]
   i. Whose constitution specifies that it is a ‘Social and Community Enterprise Company’, or
   ii. Is a registered charity “
f) State that the company is prohibited from making certain amendments to its Constitution as follows:
   “D. Prohibition on Certain Amendments to a Company’s Constitution
ZA.1. The clauses of its constitution that makes that comply with section 136(7) of the Corporations Act 2001 cannot be amended or varied.
Appendix B Methodology

The project was undertaken in 2 phases, which ran concurrently:

► Phase 1: Research and analysis.
► Phase 2: Formulation and testing of key findings and recommendations in stakeholder interviews and workshops, along with reporting.

Phase 1 consisted of 5 work streams as follows:

► Work stream 1: Identify the potential benefit to the Commonwealth Government of different forms of SII. Background, definitions and assessment criteria are addressed in Section 2 and realised evidence is discussed in Section 3.

This phase consisted principally of desk research to define SII and the full breadth of activities that fall within this definition; to synthesise the existing evidence on the potential and realised benefits and to determine assessment criteria. The definition, classifications and assessment criteria were agreed with the Partnership working group.

► Work stream 2: Identify where SII approach might be a valuable tool for Governments to more efficiently and effectively achieve their objectives. Addressed in Section 4.

We conducted desk research in respect of Commonwealth Government programs to identify the high-level areas that may benefit from a SII approach. This desk research was complemented by stakeholder interviews with key persons and department representatives as described in Phase 2.

► Work stream 3: Quantify the benefits to governments and how these benefits are realised. Addressed in Section 4.8.

We quantified the hypothesised benefits identified in work stream 1 in respect of the priorities identified in work stream 2, through a review of the available published documentation and research into the quantification of potential benefits arising from the use of SII mechanisms.

► Work stream 4: Potential actions Governments can take to support SII in Australia, e.g. tax incentives, capacity building, investment readiness, social enterprise. Addressed in Section 4.9.

The outputs of the three previous work streams were used to identify the potential actions governments might take to stimulate development of social impact initiatives, incorporating the recommendations of recent relevant Australian reviews and the range of actions governments in other jurisdictions have taken. This work stream was supported by our legal, tax and regulatory subject matter resources.

► Work stream 5: Provide a range of case studies that demonstrate examples of successful SIIIs that could be replicated in Australia Addressed in Section 5.

We prepared a range of specific case studies, in liaison with DSS and the Partnership.

Phase 2 comprised a series of interviews and workshops, in liaison with DSS and the Partnership. A variety of stakeholders were identified and interviewed in a mixture of formal and informal settings.
## Appendix C Stakeholder and informant interviews

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<td>Social Impact Investment: The role of government &amp; policy</td>
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Appendix D Key related documents

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