

## Your questions answered

In recognition of the need to try a different approach to tackling challenging social issues facing the Queensland community, the Queensland Government is investigating the value and benefits of Social Benefit Bonds.

Queensland is not the first jurisdiction investigating SBBs. In Australia, both New South Wales and South Australia governments have or are testing SBBs. Overseas, both the United Kingdom and United States have adopted similar products. These Q&As are based on the experiences in these other jurisdictions, and also outline what we expect to achieve in Queensland.

### Q. What are Social Benefit Bonds?

A. Social Benefit Bonds are a form of Social Impact Investment under the broader framework of payment or contracting for outcomes. Social Impact Investment strategies seek to create both financial returns and positive social impacts that are measured – both in terms of financial and social impacts.

SBBs can take a variety of transactional and contractual forms. In essence, a SBB is an outcomes-based arrangement involving the government, private investors – sometimes through a financial intermediary – and a service provider.

As an outcomes-based arrangement, payment by the government is dependent on demonstrating the delivery of outcomes. The outcomes underpinning the arrangement are identified, defined, agreed and measured as part of an iterative and collaborative process involving all of the participants or their representatives (in the case of the investors).

In Queensland, we will examine ways to partner with service providers and the private sector in the areas of re-offending, homelessness and issues facing Aboriginal and Torres Strait Islander people.

### Q. Are there other models for social investment?

A. In addition to Social Benefit Bonds, other governments, both in Australia and overseas, are already exploring and using these types of investments. While they can take different forms, there must be an intentional, pre-

determined social impact as an outcome from this type of investment.

Social Impact Investment can include loans, bonds and equity or similar investments. They can also include incentive payments and other payment-by-results mechanisms.

SBBs are one transaction type in the overall Social Impact Investment spectrum. As such, SBBs may not suit all types of services or organisations and consideration is needed as to whether this specific investment tool is suitable.

### Q. How do Social Benefit Bonds work?

A. Social Benefit Bonds can take a variety of transactional and contractual forms. In essence, a SBB is an outcomes-based arrangement involving the government, private investors – sometimes through a financial intermediary – and a service provider.

Effectively, the SBBs involve:

- private investors providing the initial capital to cover the cost of delivering a service (or an intervention) by a service provider to improve or deliver a defined social outcome
- service provision or intervention that is aimed at early intervention or prevention to avoid or limit the severity of the social issue for the people in the target population
- the government paying private investors their principal investment and a financial return if the agreed social outcome has been achieved and verified, at the end of the contracted period (which can be five to 10 years).

For the government, achieving the defined social outcome is expected to reduce

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demand and in turn expenditure on acute and crisis services. The resulting public sector avoided costs can then be accessed to repay the principal and provide a dividend to the investor.

Payments to investors – principle, financial return and/or both – are dependent on the delivery of the social outcome. When developing the SBB, all parties will need to agree to a defined social outcome. This defined social outcome then becomes the trigger for making payments through the arrangement.

### Q. Who is typically involved in Social Impact Investment?

A. Social Benefit Bonds can involve a number of participants. The key participants are:

- investors who provide finance under agreed terms
- financial intermediaries who focus on how supply of and need for financing can be matched on appropriate terms
- service providers who require finance to deliver services with a view to achieving social outcomes.

Investors provide finance for social investment. Investors can come from a variety of sources, but generally include philanthropic foundations (including public and private ancillary funds), financial institutions (including banks, credit unions and development finance institutions), superannuation funds, retail funds and wealthy individuals and families.

Investors often provide finance expecting to achieve both financial and social returns. While expectations around size and nature of returns may vary, each investor aims to realise both the social outcomes and the financial gains that have been negotiated in the terms of the bond.

Financial intermediaries – including major banks and financial consultancies – can be involved in developing the SBBs and facilitating negotiations between the parties. Financial intermediaries generally perform one or all of the following functions in the SBB process:

- working in close collaboration with Government and service providers to identify outcomes and design contracts that underpin the service at the centre of the SBB
- raising capital from the investors to support the financial and social returns identified
- managing the contracts underpinning the service delivery and ongoing operation of the SBB.

Service providers seek finance to deliver a service that is innovative in nature in terms of its delivery or focus. Service

providers have a social purpose and are typically NGOs (Non-Government Organisations), social enterprises or similar entities.

Through SBBs, service providers seek capital or investment to deliver an identified service or program. In order to attract this investment, service providers must ensure that their proposals and, more broadly, operational model are robust. In other words, they need to be able to demonstrate how a positive social outcome will be achieved and what potential exists for a financial return to investors arising from the proposed service.

### Q. Why is the Queensland Government undertaking a SBB pilot program?

A. Social Benefit Bonds are outcomes driven. They provide a financing structure whereby government only pays for improved social outcomes when demonstrated – as opposed to when services are delivered.

If agreed outcomes are achieved, associated service delivery costs to government will be avoided over the long term.

Additional funds will be attracted from private investors to finance new social services and produce positive outcomes. When contracted outcomes are demonstrated, a return will be paid to investors.

More broadly, the aim of the SBBs pilot program is to explore new ways of funding and delivering social services that achieve improved outcomes for Queenslanders facing complex social issues. They are the centre of the transaction.

Specifically, the government is piloting SBBs to achieve:

- greater focus on the delivery of outcomes to clients, rather than outputs, which will ensure that Government only pays if the outcome is delivered
- increased investment in early intervention and prevention, which, if effective, can reduce future demand for acute and crisis services and free up public funds for other priorities
- innovated service delivery by being focussed on results, not on prescribing a specific service – enabling service providers and investors to be flexible in designing new services or interventions
- improved evidence base and availability of robust data to support the delivery of the pilot SBBs, which will inform decision making and evaluation of specific policy areas.

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The pilot SBBs will also maintain transparency and accountability through the structure of resulting transactions, including the need to specify roles and responsibilities of each party and outcomes of the arrangement.

### **Q. What is the status of the Queensland Social Benefit Bonds pilot program?**

A. The Social Benefits Bonds pilot program was announced in the 2015-16 State Budget.

Queensland Treasury has started work on establishing the SBBs pilot program – with an initial focus on stakeholder engagement and consultation with the financial and social services sector, feasibility assessments and exploration of pilot options.

Between July and December 2015, Queensland Treasury will consult and engage with external parties. The initial focus of this work will be to gain a detailed understanding of the three service areas (re-offending, homelessness and issues facing Aboriginal and Torres Strait Islander people) and to inform the formal approach to the market.

Queensland Treasury recognises that we not only need to engage and involve both the social services and investment sectors, but also work across Queensland Government agencies to deliver a well-rounded product.

Throughout the pilot program, key elements of the SBB arrangements will be explored and developed, including outcomes, financial structures and payment frameworks.

At this stage, it is proposed that interest from the market will be sought in early 2016.

As has been the experience in other jurisdictions, it is anticipated that procurement, contracting and implementation will take around a year to complete.

### **Q. What are the expected benefits for the Queensland Government?**

A. Social Benefit Bonds can potentially deliver both social benefits as well as economic returns for the government. Expected benefits include:

- greater focus on the delivery of outcomes for clients as the government will only fund services that are demonstrated to have delivered agreed outcomes
- improved flexibility and innovation in the delivery of social services through working collaboratively with the social services sector to facilitate the development

of services that deliver positive social outcomes for individuals and families

- increased emphasis on early intervention and prevention services, which, if effective, can reduce future demand for acute services and, potentially, free up public funds for other priorities
- improved evidence base and availability of robust data for use in decision-making and evaluation both for the new services and the broader decision making processes for both government and the broader social services sector.

The SBBs pilot program will explore processes and approaches that could both deliver and maximise these benefits over time.

### **Q. What are the challenges to the development of Social Impact Investments in Queensland?**

A. The Social Benefit Bonds pilot program presents opportunities to learn how SBBs can be applied in Queensland. This pilot program will present challenges that will need to be addressed throughout the process. We will need to:

- ensure that the proposed service or social intervention is based on clear evidence that the investment will deliver improved social outcomes for the target population
- ensure that the desired outcomes of the pilot SBBs are specified and can be measured to provide clear evidence that the service or social intervention is successful
- develop a shared understanding with all participating parties of what the benefits are for the target population and, more broadly, for Queensland communities
- develop capability and capacity in Queensland for social services sector and agencies to sustain development and management of the pilot SBBs over time
- ensure transparency of the transaction – especially in terms of costs, risks and benefits under the arrangement
- ensure there are sufficient economies of scale and diversification typically required for larger investors to participate in this type of transaction.

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### **Q. Why doesn't the government just fund the services directly?**

A. The focus of the Social Benefit Bonds pilot program is to encourage the introduction of new services additional to those already in existence.

Typically, SBBs focus on delivering early intervention or prevention services. In contrast, the main focus of the government delivered services is on the acute end of the services spectrum. The SBBs pilot program provides the opportunity to develop new services aimed at intervention to provide assistance before urgent or acute support is required. This will assist in managing future demand for acute services.

Innovation comes with inherent risks around achieving success. The government will only pay when agreed outcomes are achieved from these services. The risk around the effectiveness of the service offering rests with the service provider and investors.

Accessing capital from private investors means that the new services can be delivered in addition to what is currently available. If the pilot program is successful, the government can fund repayment of principal plus a return to investors, as well as better manage future acute service delivery demand and/or costs.

### **Q. Why is the government sharing benefits with investors so they can profit from social programs?**

A. Social Benefit Bonds offer an alternative way to work towards delivering both social benefits as well as financial returns.

Both the government and the non-profit sectors face increasing demand for services. For government, given available funding, it is not possible to fund every program to meet all demand.

The SBBs pilot program is an opportunity to attract additional funds from private investors to finance social services and produce positive social outcomes. This will mean that new funding is available to deliver new services to improve outcomes for individuals and families. The new services are expected to be aimed at early intervention and prevention which are expected to generate longer term savings for government.

A return on investment is traditionally expected from investors providing finance. In the case of SBBs, this return

is only paid to investors when the contracted outcomes are evaluated and achieved. The benefits are shared only when there is clear evidence that the outcomes have been delivered that will avoid service delivery costs for Government.

SBBs are structured to deliver both social benefits and financial returns for all participants involved in the arrangement.

### **Q. Is a Social Benefit Bond different from government grants and service contracts? If so, how?**

A. Social Benefit Bonds are different from government grants and service contracts.

Traditionally, government grants and service contracts have been based on inputs and outputs and delivery of funded social programs. There is a move towards outcome-based service contracts. The outcomes reflect the extent to which the social issue is being addressed, such as reducing rates of reoffending. While SBBs are a vehicle to deliver a payment by outcome, they are unique financial instruments and distinct from grants and service contracts.

SBBs focus on providing funding for the delivery of demonstrated outcomes. Funds are provided by private investors to service providers who deliver the service which has been designed to achieve the positive social outcome that has been agreed by all participants under contract. A successful SBB aligns the interests of multiple stakeholders to achieve positive social outcomes and transparently documents this arrangement to ensure all parties are accountable.

### **Q. What happens to a Social Benefit Bond if the focus of the government's service delivery changes?**

A. A Social Benefit Bond is underpinned by a series of agreements or contracts which document the arrangement and agreed outcomes that trigger payment by the government. Unlike grants and service contracts, SBBs typically run for a longer term than a standard contract – five to 10 years in some instances.

It is therefore reasonable that a SBB could operate across terms of government. The documented agreements or contracts – including the agreed outcomes – ensure constancy across the life of the agreement.

### Q. How can I participate in the Social Benefit Bonds pilot program? Are there risks involved?

A. The risk exposure – both the extent and the nature of those risks – varies for stakeholders involved in Social Benefit Bonds.

The investors and financial intermediary are likely to bear the financial risk associated with the SBBs – but also share in the financial return from a successful SBB. How this risk is shared across these parties is dependent on the structure of the resulting SBB.

For service providers (especially NGOs), they are likely to bear the operational risks associated with delivering the service and achieving the outcomes identified in the SBBs. To take on this role, NGOs will need to demonstrate their capacity and capability to participate in the pilot SBB.

Each participant in the SBBs pilot program will need to determine their own capacity to engage with the process and to manage the risks associated with the transaction.

### Q. How will outcomes be measured? How can you be sure measurement is accurate?

A. Outcomes will be identified and supporting key performance indicators will be defined and agreed. Timing and triggers for government payments for the pilot Social Benefit Bonds will also need to be determined and agreed.

Determining and defining outcomes will be dependent upon the availability and accessibility of relevant data. This work is expected to occur during the procurement, contracting and implementation phase of the SBBs pilot program.

Similar to the experience in other jurisdictions, independent certifiers could be commissioned to verify the achievement of indicators and outcomes to inform the payment schedule.

SBBs are typically supported by contracts and operation manuals which would document the transaction and include dispute resolution arrangements. These would be documented before the start of each pilot SBB.

Significant effort will be required to ensure the chosen indicators are an accurate reflection of the agreed outcome, and do not create perverse incentives. Specific arrangements will depend on the nature of the bond.

### Q. Achieving social outcomes can take a long time. How long will the Social Benefit Bonds run?

Social Benefit Bonds typically operate over a five to 10 year period. It is anticipated the key outcomes on which payments will be made should be delivered within this timeframe.

It is appreciated that broader implications of these social outcomes may be generated beyond the term of the SBB. For example, an individual who gains or returns to employment is likely to generate improved social outcomes beyond the term of the SBB.

### Q. Where can I get more information about investing in Social Benefit Bonds?

A. Information on the pilot Social Benefit Bonds will be made available in the near future. Investors and organisations interested in participating in a SBB or other Social Impact Investment should speak to their financial advisor or contact Social Impact Investment intermediaries in the first instance.

### Q. Can you recommend further background material on Social Benefit Bonds, or where can I find out more about Social Benefit Bonds in general?

A. Jurisdictions in Australian and around the world are investigating or adopting forms of Social Impact Investment – including Social Benefit Bonds (SBBs). Below are links to repositories of information available in these other jurisdictions that may be useful in developing an understanding of this topic:

#### Australia

- New South Wales (NSW) – [The Social Impact Knowledge Hub](#) is overseen by the Office of Social Impact Investment within the NSW Government.
- South Australia (SA) – [The SA Government](#) is currently exploring Social Impact Bonds.

#### Overseas

- United Kingdom (UK) – The Centre for Social Impact Bonds [Knowledge Box](#) captures the experiences of the UK across a range of Social Impact Bonds.
- New Zealand – The government is piloting social bonds, which is led by the [Ministry of Health](#).

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In addition to governments, there is a range of international research and other organisations active in this area. Below is a sample of entities where further information on SBBs may be found.

- United States – MaRS Centre for Impact Investing has a [Social Impact Bond Technical Guide for Service Providers](#).
- United States – The Social Impact Bond Technical Assistance Lab at the Harvard Kennedy School has a range of publications available.
- United Kingdom – The Early Intervention Foundation, a charity organisation, has a [guide](#) to using social investment, with a focus on Social Impact Bonds.
- Israel – Social Finance Israel is a financial intermediary and has announced its intention to develop SBBs in employment, reoffending, health and education.

The above is not an exhaustive list of resources. Other countries active in SBBs or Social Impact Investment more broadly include Belgium, Canada, Germany, Ireland and The Netherlands.

### Further information

If you would like to receive updates on the SBB Pilot Program please register your interest at

**[www.treasury.qld.gov.au/SBB](http://www.treasury.qld.gov.au/SBB)**

or contact us by email on [socialbenefitbonds@treasury.qld.gov.au](mailto:socialbenefitbonds@treasury.qld.gov.au)