



Response to the Commonwealth Government's Social Impact Investing Discussion Paper

27 February 2017

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Executive Summary

Social Ventures Australia (SVA) welcomes the Commonwealth Government's *Social Impact Investing Discussion Paper* (the Discussion Paper) along with the opportunity to provide comments and recommendations for developing the Social Impact Investment (SII) market in Australia.

SVA is a non-profit organisation that works with partners to improve the lives of people in need in Australia, including through fostering socially focussed initiatives and developing an evidence base of what drives social impact.

Based on our experience, SVA is of the view that there is a significant role for the Commonwealth Government to play in fostering a diverse SII market and participating in targeted transactions that will achieve greater social outcomes for the people of Australia.

SII is the investment of private capital to achieve social and financial returns. Currently the Australian SII market is on the cusp of a growth phase and there is a great opportunity for it to mature quickly as long as the right supporting infrastructure and initiatives are in place.

Therefore, SVA has recommended a series of initiatives through which the Commonwealth Government could support the Australian SII market to grow, provide vital infrastructure, and underpin investments that would deliver measurable and desirable social outcomes.

The Commonwealth Government can play an active role in expanding the Australian SII market by:

- creating an enabling environment to encourage more private capital into social impact investing;
- providing funding or co-funding for investments which will deliver better social outcomes;
- appointing a Minister with responsibility for Social Impact Investing;
- creating an Office for Social Impact Investment to sit within the Treasury;
- generating a national Social Impact Bond capability;
- developing a National Housing Finance Aggregator;
- supporting SII development through improved access to data, data linkage and datalabs;
- supporting social enterprises to become 'investment and contract ready';
- using government purchasing power to create social value through social procurement;
- bolstering social impact investment intermediaries; and
- making changes to the regulatory environment in order to remove barriers to investment.

Whilst we haven't made specific recommendations in relation to the principles, we have made comments on these throughout the document.

1 Introduction

Social Impact Investing (SII) is the investment of private capital to achieve social and financial returns. While the Commonwealth Government's *Social Impact Investing Discussion Paper, 2017* (the Discussion Paper) has identified many important features and benefits of SII and highlighted a number of high profile examples, SVA believes that there is an even wider array of opportunities to foster an Australian SII market than those canvassed in the Discussion Paper.

SII can take many forms, including but not limited to investments in social enterprises; social impact bonds, or investments through pooled funds.

SVA is of the view that there is a significant role for the Commonwealth in fostering a diverse SII market and participating in targeted transactions where it will achieve greater or more efficient social outcomes.

Based on an analysis of the current operation of the SII market, SVA recommends a series of initiatives that would deliver measurable social outcomes and support the Australian SII market to grow and mature.

SVA also supports the view that SII can:

- Share financial and performance risk with investors and service providers – allowing better risk management for Governments;
- Help improve accountability and transparency of performance through monitoring of progress against agreed social outcomes linked to a financial outcome;
- Encourage Governments to better utilise their data to gain insight into the cost of disadvantage and the impact of existing and new interventions;
- Build stronger partnerships between Government, community and private sectors to solve social problems;
- Bring new pools of funding to help scale solutions to large social problems; and
- Assist Governments and service providers to better understand and quantify the cross-portfolio costs and benefits of the delivery of social services, including early intervention and prevention programs.

There are significant opportunities for the Commonwealth to grow the SII market including developing a national social impact bond capability; new social and affordable housing finance mechanisms; improving data capability and boosting the investment readiness of social enterprises.

There are also several elements of existing SII models that are highlighted in the Discussion paper which are not unique or defining features of SII. Developing these approaches will help support future SII opportunities, however they should be considered as part of the broader Commonwealth Government social policy, not as a pre-requisite or exclusively for SII. They include:

- **Pay for Success** – Social Impact Bonds (SIBs) are a specific subset of the 'pay for success' model which incorporates financing on terms that are linked to the results of an outcomes contract. The need for outcome linked financing such as a SIB (which passes performance risk on to investors) will depend upon a) the risk appetite of the service delivery organisation; and b) the degree to which payments are deferred and contingent. Jobactive is an example of a contract that has a material pay for success component but is not linked to private capital raising. Other terms for pay for success include payment for outcomes and pay by results, however for ease, SVA has used the terminology of pay for success throughout this document.

Equally, for SII opportunities such as building new social and affordable housing, pay for success in arrears without access to working or project capital is not a viable option. Pay for success measures can give service providers greater flexibility in how they deliver services and encourage innovation in order to meet or exceed the outcomes rather than simply being judged or evaluated on 'services rendered'. They also shift risk from Government to providers but they are not always appropriate, particularly when applied to very small groups (where volatility in the results can make the risk difficult to assess and can skew the payments).

- **High Quality Outcomes Management** – When clients, service deliverers and funders agree on the outcomes they are seeking to achieve and implement a framework for monitoring and evaluating success over time, client outcomes are improved. This is particularly important where Governments are the purchaser of services but not the recipient. (CF on Outcomes management). It can also promote more dynamic management of Government contracts based on performance rather than 'head count'.

Historically, outcomes management has been underdeveloped in the community sector; supporting sector capacity will not only improve service delivery, it will also help SII readiness.

- **Outcomes Data** – Improving the quality and availability of data on what does and doesn't work to improve lives, as well as the costs of achieving those outcomes is crucial to ensuring that government, philanthropists and impact investors are funding the most effective and value for money services.

Within SII, it is essential to have access to data on:

- Baseline experience and services usage of the target population;
- Progress of a target group against agreed measures, potentially relative to a control group; and
- Unit costs of the services utilised.

The Try, Test and Learn (TTL) Fund is a welcome investment in new services to improve the lives of people who have been identified as having a high risk of becoming long term income support recipients and to closely track the impact of those services.

As TTL is underpinned by an actuarial analysis of income support liabilities, it could generate future SII based on outcomes payments from Government from the savings over time, similar to current SIBs (see Figure 8 below).

However, in its current form TTL is unlikely to lead to these kinds of SII. SII based on pay for success would need:

- Identification of a specific sub-group in the data to provide a cost baseline, and against which to compare services' outcomes;
- A large enough cohort to demonstrate statistically significant change *or* a service model which has significant impact – both of which are unlikely in the current TTL round given the level of funding available – a larger impact will likely be achieved by a more intensive and hence expensive service;
- Existing evidence of program/service success that investors could use to assess the risk associated with achieving specified outcomes; and
- Multi-year agreements to allow for the improvement in outcomes over time to 'smooth' the risk/return and give service providers room to adjust practice to improve outcomes.

Further consideration should be given to how the actuarial analysis and associated data sets could be used to:

- Support future SII including but not limited to SIBs; and
- Support government grants, philanthropic and other forms of funding to services where their performance is measured against the actuarial analysis and data.

It is essential to note that while Australia's nascent SII market presents significant opportunity to leverage private capital to improve social outcomes, there are many social policies and programs which will achieve excellent outcomes for people experiencing disadvantage but which are not amenable to SII.

These programs should nonetheless be based on solid evidence, monitored and evaluated on the basis of their outcomes and replaced if there is another program inside or outside Government which has been found to be more effective in delivering those outcomes.

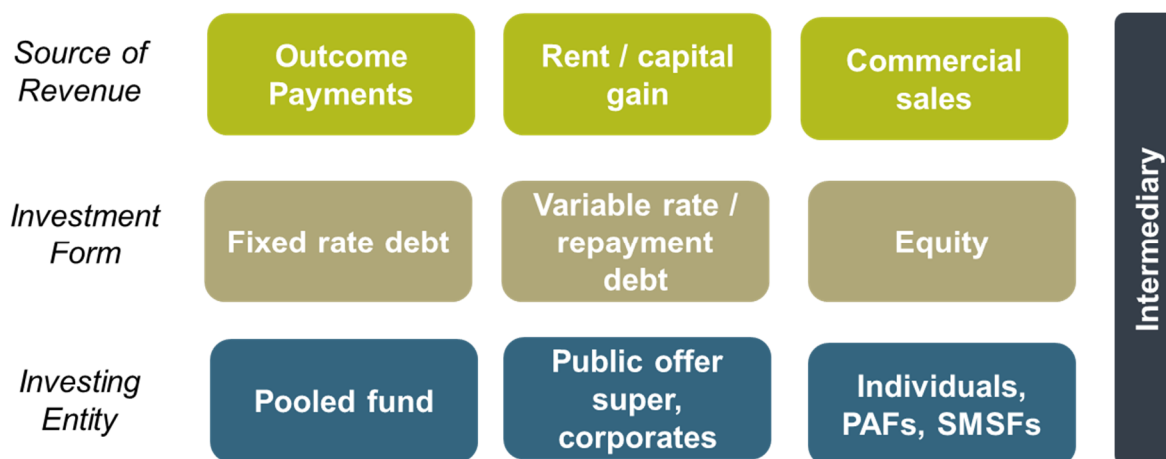
Equally, all Governments should take greater responsibility for adopting and scaling successful intervention as too often programs which have demonstrated some success have been discontinued and not replaced. This has eroded the community sector's trust that decisions are made on the basis of evidence.

2 The Impact Investing market

Impact investment has emerged from existing debt and equity markets, however it has been driven in many cases by participants with a strong connection to the community and philanthropic sector.

At its most fundamental, impact investment is about accessing private capital which takes on risk in order to achieve both a financial and demonstrable social return. It can do that in a variety of ways as illustrated in Figure 1.

Figure 1: Capital Flow for Impact Investing



For example:

- A pooled investment fund (which would in turn comprise capital from a range of investors) could lend to a social enterprise in the form of fixed rate debt (potentially on financial terms that a mainstream bank may not offer) to create employment outcomes and that loan would be repaid to the fund out of the enterprise's commercial revenue.
- A super or industry fund may invest in a large social/affordable housing project such as NSW's Social Affordable Housing Fund in order to make a financial return from social housing rent and sales of market based dwellings.¹
- High net worth individuals or a foundation might invest in a SIB that has a variable return dependent on the level of outcome payments made under a Government pay for success contract.

A range of combinations of investor, investment form and ultimate revenue source can be envisaged, not all of which exist today. For example, there is no SIB pooled fund investment arrangement in Australia at this point in time.

To achieve the creation of a range of investments, the impact market needs intermediaries that can link the capital to the investment opportunities and present the opportunities in a suitable form. Intermediaries need to have the appropriate regulatory licensing, financial skills and networks to play this role. Given the current scale of the market and the challenges in implementing transactions with long lead times (especially with SIBs), there is a shortage of genuine, long term intermediaries in the Australian impact investing market place.

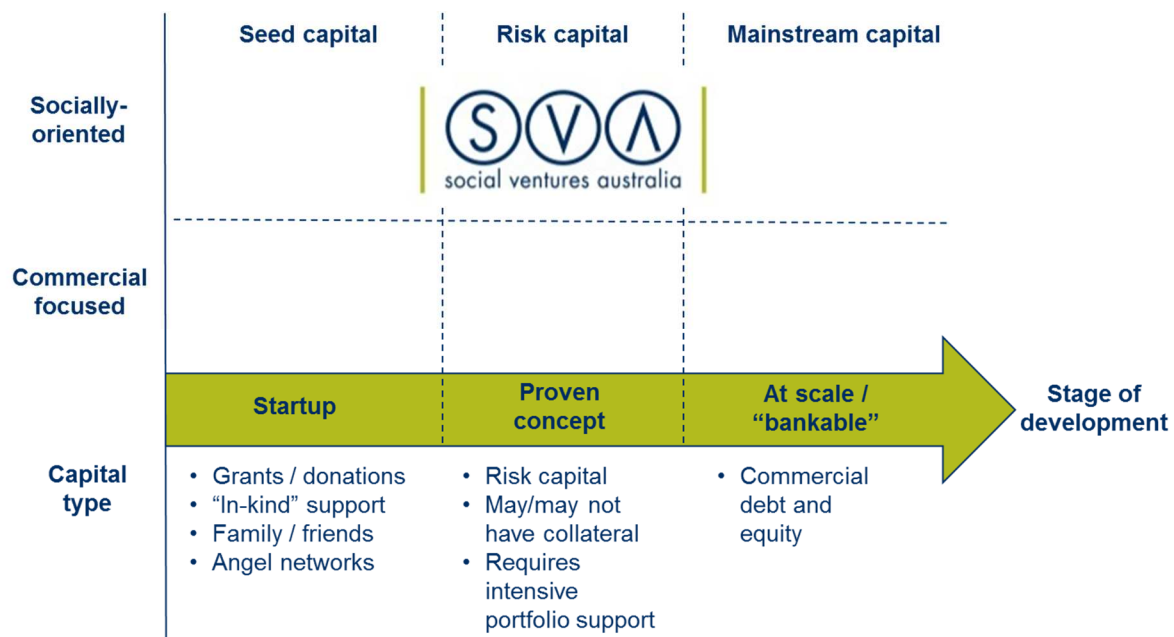
¹ <http://www.facs.nsw.gov.au/reforms/social-housing/SAHF>

SVA believes a social capital market can thrive alongside traditional financial markets. We are thus keen to share our experience in developing social impact investment through partnerships with both Government and service providers, in order for it to become increasingly part of the mainstream.

2.1 Impact Investing Participants

An effective social sector requires different types of capital for different purposes. Different participants are also more or less commercial or socially focused (see Figure 2). SVA currently plays a broad role across the spectrum of participants as it is socially oriented and facilitates a range of different capital types to the impact investing market.

Figure 2: Impact Investing Participants



Organisations such as Social Traders have deep experience in providing seed funding and supporting start-ups. Returnable capital, like debt or preferred equity, is typically not appropriate for early stage social enterprises with limited revenue.

There is a range of well-established, commercially focussed incubators and accelerators but less with expertise in more socially oriented enterprises.

At the next stage of investment scale, funds like the Social Enterprise Development and Investment Fund (SEDIF) can invest in social enterprises seeking relatively small-scale growth capital.

For scaled investments, main-stream banks have traditionally provided commercial finance but appetite to move into the social finance space is growing (if the transactions pay adequate returns based on the risk).

Superannuation fund HESTA is one of the few large-scale socially focussed investors, and has provided SVA with a \$30 million mandate for social impact investments, with the initial transactions in social and affordable housing but with scope to look at many other areas.

As the SII market develops and matures, there will also be an evolution in the kinds of investors, the nature and scale of the transactions and the role that intermediaries will need to play.

The Australian SII market is currently at a junction between Pioneering and Growth Phase (see Figure 3) with an opportunity to grow quickly with the right supporting infrastructure and initiatives.

Figure 3: Phases of SII Market Development

Phase	Investors	Transactions	Intermediaries
Pioneering	<ul style="list-style-type: none"> - Private wholesale investors as early adopters (including high net worth individuals, private ancillary funds (PAFs) and self-managed super funds (SMSFs)) - Relatively high degree of uncertainty (Government support typically required) 	<ul style="list-style-type: none"> - Small scale pilot transactions with early-stage social enterprises (often without real property assets) and larger social sector organisations trialling social enterprise - Large range of impact areas 	<ul style="list-style-type: none"> - Establishment of market infrastructure (intermediaries, specialisations, methodology and language) - Focus on capacity building, developing market awareness and trialling a broad portfolio of pilot transactions
Growth	<ul style="list-style-type: none"> - Larger scale commitments by leading institutional investors and ethically-focused institutional investors - Increasing acceptance of impact investment as a standard asset class within investment portfolios 	<ul style="list-style-type: none"> - Increasing number and size of transactions, building on successes and lessons from Pioneering Phase investments - Increasing focus on measuring impact on key societal issues 	<ul style="list-style-type: none"> - Increasing in the number of intermediaries, degree of specialisation and new product offerings - Increasing interest from mainstream financial intermediaries
Maturity	<ul style="list-style-type: none"> - Investors increasingly applying impact criteria across entire portfolio - Ability to invest in range of impact investing asset classes (property, equity, debt) - Direct participation by retail investors ('mums and dads') 	<ul style="list-style-type: none"> - Execution of a wide range of transactions providing risk/return and impact profiles to suit all investors (from 'impact first' to 'finance first') - Increasing number of 'at scale' transactions (>\$20m) 	<ul style="list-style-type: none"> - Broadening array of mainstream financial services firms and specialised intermediaries - Increasing competition between intermediaries based on track record and offering - Ongoing innovation, including introduction of secondary markets

One of the main barriers to the development of the impact investing market to date has been the relative scarcity of large-scale, investment-ready opportunities. In Australia to date, the SEDIF Funds have collectively committed just over half of their available funds (as at 31 March 2016). Similarly, in the UK, scale has been problematic in the early years of the market and Big Society Capital and its co-investors have so far drawn down only £195m of the £587m available to invest.²

2.2 SVA's experience in Impact Investing

SVA was one of the earliest participants in the Australian SII market and has been responsible for a number of the largest and most innovative transactions.

In 2009, SVA played a pivotal role in orchestrating the GoodStart syndicate comprising four non-profit organisations - SVA, Mission Australia, The Benevolent Society and The Brotherhood of St Laurence. Through the development of a new social capital model, the syndicate was able to raise \$165m to successfully bid for 650 ABC Learning Centres and is now running these centres with business discipline

² Big Society Capital, 2015 Annual Report, <http://www.bigsocietycapital.com/what-we-do/governance/key-documents>

for a social purpose. The transaction was undertaken with the assistance of the Australian Government by way of a \$15m medium-term loan from the then Federal Department of Education, Employment and Workplace Relations. This has resulted in improved quality of early childhood education for 73,000 children.

In 2012, SVA was successful in accessing a \$4m Commonwealth Government grant and matched that with \$5m of private investor capital as part of the SEDIF.³ The SVA Social Impact Fund (SIF) has been lending and investing in social enterprises, smaller housing projects and charities for nearly five years which has led to positive social outcomes in education, employment, housing and community healthcare.

SVA, along with Foresters and Social Enterprise Finance Australia, have collectively committed nearly \$20m of funding to more than 50 impact investments. In terms of social impact, the SVA SIF helped create 166 jobs for people with a disability, the long term unemployed and First Australians; built 22 social/affordable dwellings; provided funding for five doctors to deliver low-cost health care; recycled 18,437 tonnes of e-waste; and helped 500 children at risk of social exclusion participate in Lego clubs.

In partnership with Uniting and the NSW Government, SVA launched Australia's first SIB in 2013, the \$7m Newpin SBB, which used private capital to fund a restoration program for children in foster care in NSW. This pay for success model allowed Government to measure the outcomes of the program before making payments linked to the anticipated savings arising. It has also generated strong financial and social returns for investors. In the first three years of the SIB: 130 children have been restored to their families; a further 47 have been prevented from moving into out of home care; and as a result of that success the bond has paid a return 12 percent to those investors who took on the performance risk. SIBs have unlocked private capital to fund social services but they have also created a level of rigour around the assessment and measurement of impacts, costs and benefits of social programs that is quite rare.

SVA has recently launched a homelessness SIB in South Australia, the Aspire SIB⁴, and is in joint development on mental health and youth homelessness SIBs in NSW and a SIB in Queensland that will predominately support First Australian children and families through a Newpin style service. SVA has also advised the Western Australian and New Zealand Governments on the implementation and development of SIBs in their separate jurisdictions.

Currently, in both Victoria and New South Wales, there are SIBs under consideration through a request for proposal process. In Victoria, SVA has partnered with a consortium focussing on young people transitioning from out-of-home care. In NSW, SVA has partnered with GoodStart Early Learning on a proposal focussing on better outcomes for children in the early childhood education and care space.

In 2015, HESTA committed \$30 million to create a dedicated fund managed by SVA which is the largest single commitment to the local impact investment market made by an Australian superannuation fund to date. SVA and HESTA designed a dedicated fund, the Social Impact Investment Trust, to allow HESTA to make direct and indirect investments in a range of businesses, housing projects and social impact bonds that deliver both financial returns and identifiable and quantifiable social impact. HESTA's commitment therefore represents a milestone in terms of size, source and social commitment. The

³ <https://www.employment.gov.au/social-enterprise-development-and-investment-funds>

⁴ <http://www.socialventures.com.au/work/aspire-sib/>

fund is also notable for a number of innovations, in particular its impact-based incentive structure. In 2016, HESTA made a \$6.7 million investment in Horizon Housing, a community housing provider operating in south east Queensland, which is focused on increasing the supply of social and affordable housing and helping low income earners achieve home ownership in targeted areas.

In 2016, SVA was instrumental in raising \$6 million of capital from a blend of philanthropy, government, local investors and bank finance to setup Vanguard Laundry Services (VLS) which is a start-up non-profit commercial laundry based in Toowoomba. VLS will employ up to 40 people with mental health issues each year and will also operate an industry-linked career centre for a further 40 people per year by partnering with local businesses. The laundry business is underpinned by a long-term contract with St Vincent's Health and contracts with other Toowoomba businesses. SVA also provided strategic and commercial advice, brokered pro-bono legal support, recruitment assistance and support to realise this business opportunity.

In September 2013, SVA, Indigenous Business Australia (IBA) and Reconciliation Australia (RA) launched a two-year pilot Indigenous Social Enterprise Fund (ISEF) to support Indigenous social enterprises (ISEs) develop to scale and sustainability through filling an identified capital gap in the market as well as provide business support. The fund also set out to better understand the ISE market and document learnings as a way to assist the establishment of any future Indigenous-led funds. At the end of the pilot, ISEF had been approached by 165 enterprises, worked closely with 15 applicants, approved two investments, and deployed funds into one enterprise. Through evaluation of this program, it became apparent that assisting the ISE sector to grow requires a specific type of product offering that provides focused capacity development; and a more socially-oriented, flexible, and patient capital product that offers more risk-tolerance and longer-term horizons for the support.⁵

After the ISEF pilot, SVA supported the establishment of First Australians Capital (FAC) which is an Indigenous-led organisation with a vision for building a new economy driven by First Australians. FAC aims to alleviate the poverty and disadvantage in life outcomes experienced by Indigenous Australians by empowering them to create and drive their own prosperity through the strength and assets of First Australians cultural, creative and economic capital. FAC will provide concessional capital and capability support to ISEs and social entrepreneurs, and dedicated relationship management to build economic self-sufficiency within Indigenous communities to help drive a new economy in Australia.⁶

⁵ <http://www.socialventures.com.au/assets/ISEF-Lessons-Learned-Report-FINAL.pdf>

⁶ <http://www.firstaustralianscapital.org/>

3 What role can Government play in the impact investing space?

An enabling environment, with strong leadership from a host of players including government, is essential to growing the SII market.⁷ There is significant evidence, both internationally and from Australia which demonstrates how crucial Government leadership is in developing an impact investing market.⁸

3.1 Role of the Commonwealth Government

As noted in the Discussion Paper, there are a number of roles the Australian Government could play in developing the market for SII.⁹ SVA agrees that it would be an effective use of resources for the Commonwealth to create an enabling environment to encourage more private capital into social impact investing; as well as provide funding or co-funding for investments which will deliver better social outcomes for the Australian people.¹⁰

3.2 Appointment of a Minister for Social Impact

A Minister with responsibility for Social Impact Investing, usually within the treasury and finance portfolio helps to ensure appropriate exposure for SII policy which is essential to generate cross-portfolio support.

SVA recommends that responsibility for SII is allocated to either the Treasurer or potentially the Assistant Treasurer.

3.3 Office for Social Impact Investment to sit within the Treasury

Experience both in Australia and abroad suggests that a central point of coordination, usually within or associated within the Department of Treasury or Premier/Prime Minister and Cabinet, is essential to coordinate SII across government.

Representation from across government is important given the complexities in calculating both the costs and the potential outcomes across Government Departments, including the need for access to and understanding of the various data sets.

3.4 Supporting SII infrastructure and transactions

The Australian Government can also support and participate directly in the social impact investment market in a variety of ways as described in Figure 4 below. SVA has suggested a series of initiatives through which the Commonwealth would underpin specific investments with a desirable social outcome (e.g. SIBs, rents/inputs to new housing stock) and those which provide vital SII infrastructure to grow the market over time (including data, community sector capability building and social procurement).

Some regulatory changes (addressed in section 4) could also ensure that different kinds of investors have more opportunities to participate in Impact Investing, increasing the potential pool of funding for different SII mechanisms with varying risk and return profiles.

⁷ <http://socialimpactinvestment.org/reports/Australian%20Report%20Final%20190814.pdf>

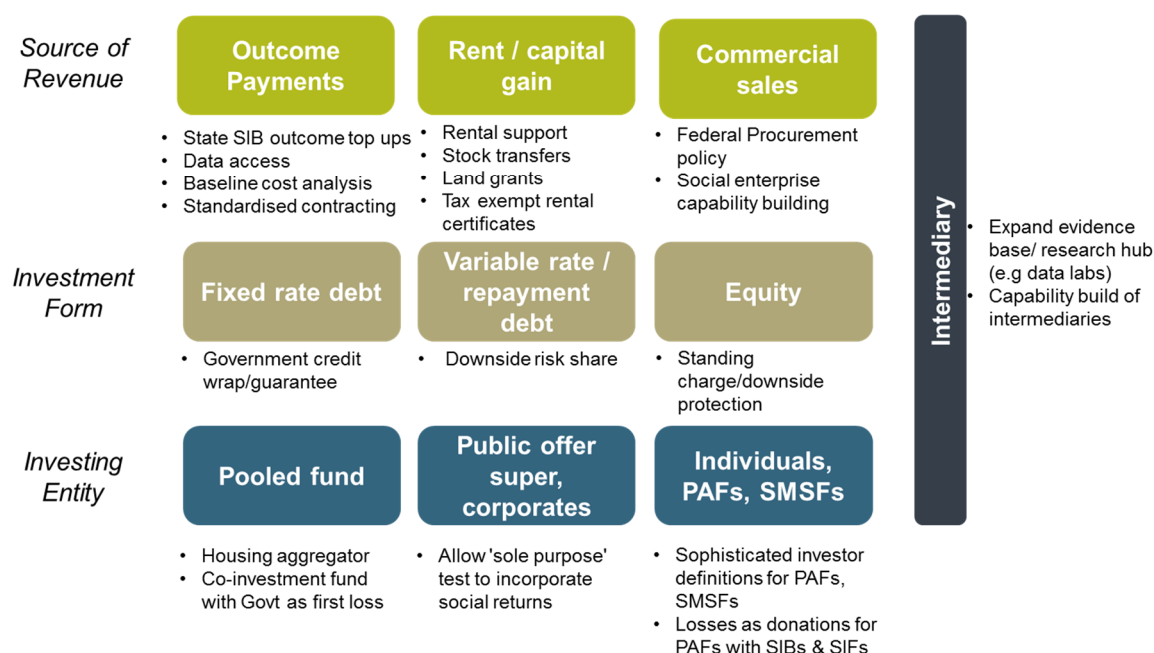
⁸ Ibid

⁹ Social Impact Investing Discussion Paper, Australian Government, 2017.

¹⁰ Ibid

Figure 4: Opportunity map for the Commonwealth Government

Government Opportunity map



3.5 Foster a National Social Impact Bond Capability

SIBs reflect a new approach to government procurement, where governments pay service providers when they achieve a set of social ‘outcomes’, rather than just on the traditional ‘outputs’ basis (see Outcomes Payments in Figure 4). SIBs typically finance preventive and early intervention services that tackle social issues that generate long term savings for government. The structure allows for a sharing of risk between the Government, service providers and private investors.

While the experience in the States has been that SIBs take time to develop, they have significant benefits beyond the individual transaction. SIBs have been shown to improve the capability of Governments and service providers to:

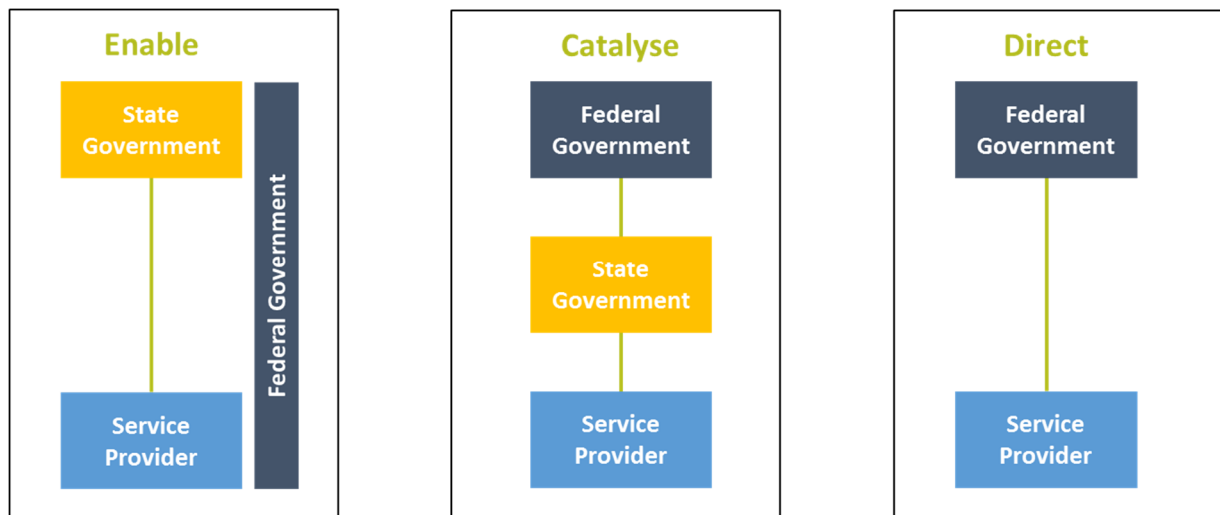
- Understand and quantify the true costs of different interventions across Departments;
- Work within outcomes based contracts;
- Rigorously monitor and evaluate service outcomes; and
- Participate in control trials.

The SIB market in Australia has to date been driven by the State Governments who have sought out programs to address State level costs including child protection, prison populations, avoidable hospital and healthcare expense and acute homelessness services. Developing a market for SIBs in Australia on a national scale will require partnerships between different levels of Government and service providers in order to be successful. There are substantial opportunities for the Commonwealth to benefit from SIBs arising from the potential long-term savings that payment for success models may generate.

The Commonwealth Government could play any or all of the following distinct roles in the Australian SIB market (Figure 5):

- **Enabler** – stimulate market development through supporting infrastructure, developing capability and providing access to data.
- **Catalyst** – catalyse State Government SIB development by enhancing deal economics via a ‘top up’ outcome fund recognising savings to the Commonwealth such as reduced unemployment benefit payments.
- **Direct** – liaise directly with service providers to develop outcomes-based contracting linked to federal cost pools e.g. social security or income support payments.

Figure 5: Options for developing Social Impact Bonds in Australia



One option for the Commonwealth Government to consider is a catalyst approach which would entail the establishment of an outcome fund to supplement State Government SIBs – see Figure 6.

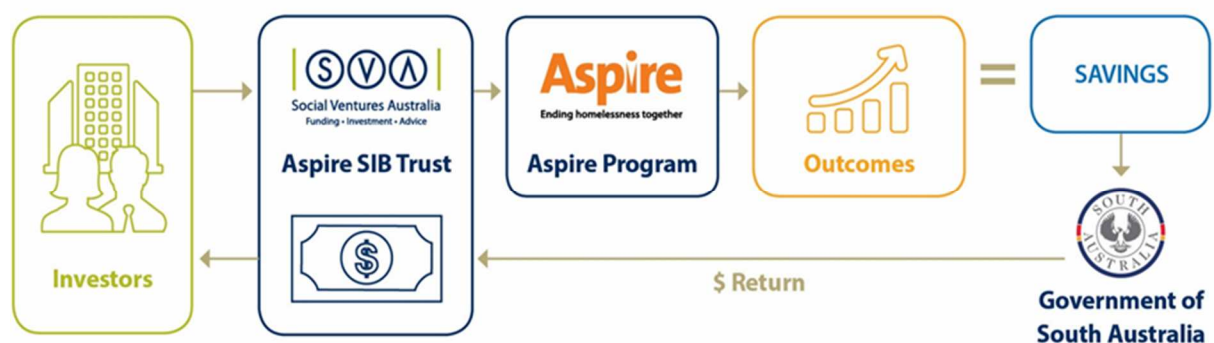
Figure 6: Outcome fund to supplement State Government SIBs

Potential Approach	Potential Impact
<ul style="list-style-type: none"> • Initial annual commitment of circa \$20m (payments for success made over 5-8 years) • Time to establish: <6 months • Contract with States, not directly with service providers (contract simplicity) • Limit to employment outcomes for simplicity • States bid for supplemental payments for high potential programs identified through their SIB RFP processes • Simple multiplier (\$1 per \$x state payments) or federal-specific outcome metric/payments (requires data sharing and establishment of measurement processes) 	<ul style="list-style-type: none"> • Potential to catalyse ~5 SIBs pa • Programs supporting ~2,000 pa high cost individuals • ~\$40m federal savings & ~\$150m state savings • Grow evidence base for ‘what works’ and deeper state/federal engagement • Catalyse national rollout/scaling
	Potential Themes
	<ul style="list-style-type: none"> • Mental health: employment as an enabler or product of improved wellbeing • Homelessness: employment as an enabler or product of stable accommodation and enhanced individual capacity • Recidivism: employment as an enabler of reduced reoffending • Youth at risk: employment as an enabler of transition from OOHC to sustainable

In this model, the Commonwealth outcomes contribution could be made directly to the State Government for simplicity. This would require data sharing between the Commonwealth and the States to track successful outcomes for the same cohort.

As a case study, the recently launched Aspire SIB is in effect generating the Commonwealth employment outcomes for no return. The Aspire SIB structure is illustrated below. A range of investors will invest \$9m via a trust in a preventative program undertaken by Adelaide's Hutt St Centre which will in turn seek to generate improved outcomes in the areas of bed days in hospital, criminal convictions and the use of acute homelessness services. Improvement against a baseline will determine the savings to the South Australian Government and a share of those benefits is passed back to investors over the 7.75 year term of the SIB. A core component of the intervention methodology is providing extensive support to individuals to enable them to re-engage with the workforce.

Figure 7: Aspire SIB Structure



SVA is currently developing a SIB in NSW for a youth foyer which will support young people exiting out of home care. The services structure and data analysis for this SIB also suggests that there will be potential savings to the Commonwealth that could generate payments for success.

The Commonwealth could also become directly involved in the market by piloting and commissioning SIBs using actuarial valuation data (see Figure 8).

Figure 8: Pilot ‘Direct’ Commonwealth commissioned SIBs utilising actuarial valuation data

Potential Approach	Potential Impact
<ul style="list-style-type: none"> Commence with two pilot SIBs to create/test procurement and contracting template, then expand/replicate ~\$15-25m payments per SIB (payments for success made over 5-8 years) Planning, tendering, development and capital raising timeline ~1.5 years Leverage actuarial valuation outputs for cohort identification, baseline cost determination and evaluation framework Reshape current grant funding or link to cost reduction 	<ul style="list-style-type: none"> ~\$25-\$50m federal savings per pilot SIB Grow evidence base for ‘what works’ Catalyse national rollout/scaling
	Potential Impact
	<ul style="list-style-type: none"> Early learning: interventions targeted at high risk groups (e.g. incarcerated parents, Indigenous, generational welfare dependency and refugees) Youth Unemployment: interventions targeting youth at risk of long term welfare dependency Disability: early intervention programs aimed at reducing NDIS liability

Given the extensive work that has already been undertaken on the actuarial analysis of income support liabilities, there is significant potential to develop Commonwealth employment related SIBs.

Like all outcomes contracts, the measures of success need to be carefully designed to ensure that the wellbeing of the people receiving the service is improved and that perverse incentives are avoided. For example, outcomes linked to sustained employment are more likely to be indicative of improved long term wellbeing than simplistic short term measures such as no longer claiming a particular income support payment. This is particularly evident for groups who move on and off income support.

The case study below is an example of a high potential program for future impact investment. There are a range of other programs where impact investing could be used to finance future initiatives in order to prove models and take them to scale.

Case Study: Industry Employment Initiative Youth Pilot

- Philanthropically funded collaboration between SVA, Brotherhood of St Laurence, Jesuit Social Services and Mission Australia
- Demand-led employment model: works directly with national employers to train, place and support long-term unemployed young people into sustainable employment
- Service providers co-design a training and employment pathway with employers
- Underpinned by a best practice Measurement and Evaluation framework
- Department of Employment will provide data for a comparative group of job seekers against which to assess participant's outcomes
- Principles incorporated in program design: employability skills, business partnerships, personalised support and alternative employment pathways

3.6 Outcomes commissioning

SIBs are a particular form of outcomes contract but there are other examples – the most prominent in the Australian social policy context is jobactive which has a mixed outcomes/service payment model; although it should be noted that it is also a more prescriptive service structure than some other outcomes contracts. As a large procurer of services from the community sector, the Commonwealth has the opportunity to support further outcomes commissioning which will deliver benefits for clients of services and support the growth of SII opportunities.

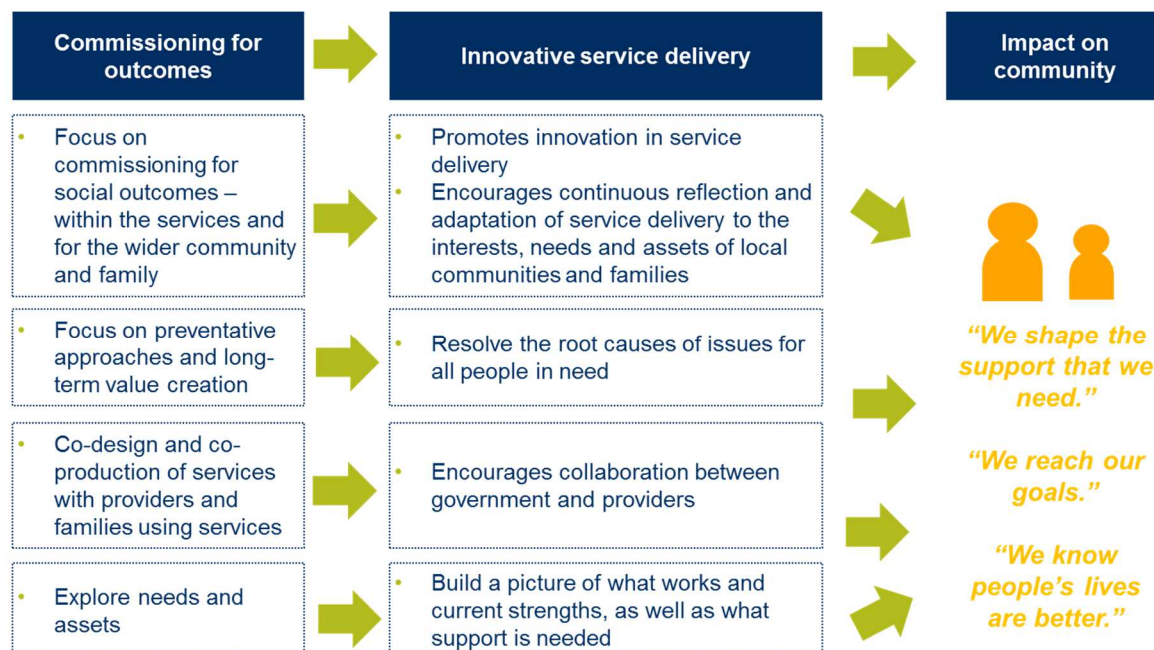
Growth and maturity in the way Government uses outcomes based contracts will likely produce new capital raising instruments other than SIBs which will help to scale the impact of successful services.

Traditionally, Governments have funded services by paying for tightly defined inputs, acquittals and activities which have created barriers to innovation and therefore worse outcomes for people receiving services along the way. SII will be both a beneficiary of and a catalyst for outcomes contracting as it will encourage Government to pay for successful outcomes.¹¹

To be successful, outcomes based commissioning must include a process for working with the group of people who will receive the service to identify their needs and desired outcomes; careful assessment of the data points on which success is measured; and contracting structures which share risk appropriately and avoid perverse incentives.

¹¹ <http://fsi.gov.au/publications/final-report/>

Figure 9: Outcomes-based contracting aligns funding with clients' goals



3.7 Social and Affordable Housing

There is a significant shortage of social and affordable housing in Australia. SII can make a meaningful contribution to filling this gap by unlocking new capital to increase supply. In this case, the SII is not supported by a Government outcomes payment or by revenue derived from commercial activities, but by rent and capital gains (see Figure 4).

In order to stimulate new social and affordable housing, the following table (Table 1) describes the levers available to government, who would have responsibility and what the level of impact would be if implemented.

SVA is of the view that as the Government develops its housing policy including potential changes to the National Affordable Housing Agreement between the Commonwealth and the States, it should determine which combination of these levers will optimise the SII to deliver new social and affordable housing stock. Our suggestions for these levers are highlighted in red in Table 1.

Table 1: Levers for new social and affordable housing

Lever	Details and examples	Gov't role	Scale of Impact
Construction or development costs	<ul style="list-style-type: none"> - Innovative design and build concepts such as modular housing - Large scale development capability of Community Housing Providers (CHPs) to reduce project costs 	N/A	LOW
Financing costs	<ul style="list-style-type: none"> - Interest rate subsidy – equivalent of 2-3% as a cash transfer - Government guarantee administered by a financial intermediary 	Federal and State	MEDIUM
Financing terms	<ul style="list-style-type: none"> - Long dated financing tenor up to 15-20 years (funding certainty for borrowers) - Lower debt servicing hurdles where prudent 	Federal and State	MEDIUM
Management rights transfer	<ul style="list-style-type: none"> - Leverage rental income stream to develop new stock - Limited by maintenance liabilities on existing stock 	State	MEDIUM
Planning regulations	<ul style="list-style-type: none"> - Inclusionary zoning – 10-15% based on LGA needs assessment - S.94 contributions waived for CHP residential development projects 	State	MEDIUM
Income support	<ul style="list-style-type: none"> - CRA moved to floating mechanism linked to market rent 	Federal	MEDIUM / HIGH
Tax incentive	<ul style="list-style-type: none"> - Replacement mechanism for NRAS - Tax credit for new social and affordable housing 	Federal	HIGH
Land costs	<ul style="list-style-type: none"> - Partnership between NFP, land banks and CHPs with alignment of mission and purpose - Land gifted or leased at peppercorn rent from the State 	State	HIGH
Land or stock ownership transfer	<ul style="list-style-type: none"> - Title transfer of social housing to CHPs with leverage commitments - Medium-long term leases (20-30yrs) of social housing to CHPs with land swap 	State	HIGH

In line with the recommendations of the Council on Federal Financial Relations Affordable Housing Working Group, SVA also strongly supports the development of an Australian Housing Finance Aggregator (AHFA) – a pooled investment relying on the rental returns to CHPs – to improve the financing costs and tenure for CHPs developing new stock. The proposal for an AHFA has been outlined in the joint SVA Macquarie Group submission to the Working Group and costed in the SVA budget submission.¹²

¹² SVA and Macquarie Group, Joint Submission to the Council on Federal Financial Relations Affordable Housing Working Group
http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2016/CFFR%20Affordable%20Housing%20Working%20Group/Submissions/PDF/SVA_Macquarie.ashx

Case Study: Australian Housing Finance Aggregator

Australia has a mismatch between the supply of appropriate capital and the underlying demand for social and affordable housing. Improved access to capital is an important piece of the puzzle. Currently in Australia, there are significant barriers to generating interest from the private sector for the provision of finance for social and affordable housing.

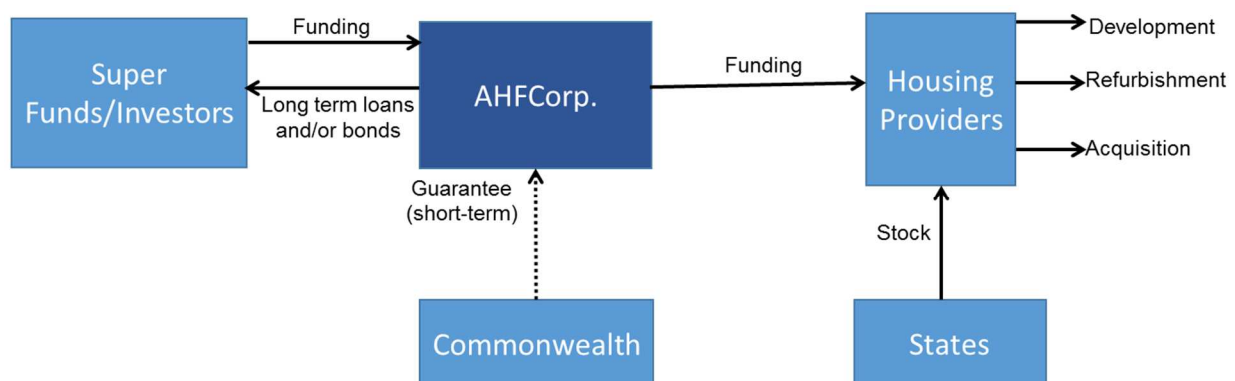
There is significant potential in impact investing for a housing finance aggregator to use private sector financing including institutional capital to help bridge the gap in supply. This would then contribute to increasing the stock of social and affordable housing (SAH) across the country and bring about better social outcomes. The use of a housing finance aggregator should be one part of the solution for attracting more private capital into the SAH market in Australia.

It is SVA's view that the model for a bond aggregator should follow that of the UK's The Housing Finance Corporation (THFC) by establishing an Australian Housing Finance Aggregator entity that:

- aggregates funding needs for housing providers (including CHPs, Real Estate Investment Trusts and Special Purpose Vehicles);
- undertakes credit assessment of these entities;
- sources periodic tranches of debt from institutional investors in its own name;
- ensures continuous compliance with covenants to ensure SAH providers are solvent and able to pay their obligations with right to procure rectification of compliance breaches;
- sources SAH providers' repayments via free cash flows from secured properties; and
- on-lends debt to SAH providers at cost of debt plus margin to cover costs, with borrowers subject to covenants and their repayment obligations secured.

SVA agrees with the Working Group's further recommendation that Government support is required to efficiently leverage long-term institutional investment for affordable housing and provide greater value for government expenditure. Through the Commonwealth Government's pre-budget submission process, SVA has recommended the Government invest in a national housing finance aggregator in order to facilitate the delivery of more social and affordable housing in Australia.

Figure 10: Proposed structure for the Australian Housing Finance Aggregator



3.8 Data

For SII to be successful over time, access to good outcomes data, good unit cost data and savings data is essential. It is critical to outcomes based payments (see Figure 4) but increasingly both investors and Government will want more sophisticated outcomes measures for other types of SII.

Where holds data at the level of an individual on key outcomes that a service provider is attempting to effect, lack of access fundamentally constrains impact measurement. Lack of access results in service providers and funders either:

- Using expensive, bespoke processes to collect data on outcomes or proxies for outcomes; or
- Not attempting to understand what happens to their clients in key outcomes areas beyond anecdotal evidence or low level evaluation.

Improving the pipeline of potential SII also requires improved data gathering and analysis capability within services and a better interface between Government and non-government data sets.

Access is not simply a case of authority to use data, it is also a question of the burden and cost of obtaining and using the data. While fee-for-service models, including as is currently the case with some ABS datasets, make sense for cost recovery to government, they can inadvertently hamper better service provision by agencies contracted by governments.

The Commonwealth Government should consider making more of its data available so that parties outside of government can identify new SII opportunities to deliver interventions that will bring both social and financial returns.

Case Study: Data to support Newpin Social Impact Bond

The Newpin SIB funds a service that reconnects children who are in the out of home care system with their families where it's safe and appropriate to do so, in order to improve the wellbeing and life prospects of those children. Reductions in time spent in out of home care creates significant savings to governments. Investors are paid on the basis of family restorations as this was determined to be the appropriate 'trigger' for both the financial and social outcomes.

There are several types of data required for this to function effectively:

- Data that has contributed to evidence base on why restorations generated better outcomes for children and their families than remaining in out of home care;
- Data on the costs associated with out of home care;
- Data on the propensity for children who are restored to their families to re-enter out of home care; and
- Data on a comparison group of children to determine the impact of the program on long term outcomes.

Data linkage

The complex nature of social problems means that linking and matching data sets is also necessary to build a fuller picture of the causes and effects of problems and proposed solutions, including causal relationships between services provided and outcomes for clients. There are currently barriers both across Departments within a government and between levels of government to data linkage.

As was highlighted in relation to the opportunity for the Commonwealth to provide top-up payments for State SIBs, data sharing between Commonwealth and States could help unlock payments for success for future SII.

There is a great opportunity for data and evidence in these settings to be joined and shared with other social service data (with protections and controls) to create a deeper understanding of ‘what works’ but also of the more complex question of ‘why’ or ‘what works, for whom, under what conditions’ as well as the costs and benefit of different services across governments.

SVA strongly supports the broader Commonwealth agenda to make better use of, share and link administrative data sets between and within Governments for social impact.

Case Study: Datalabs

One way to improve the community sector capacity to generate and use data and test initiatives against Government data sets, is through a data lab. Improving data capacity and capability of service providers will be essential to improve the pipeline of outcomes based SII as well as lifting of the level of rigour of outcomes measurement for all forms of SII. This will help to underpin investor confidence in not only the financial returns, but also the social returns.

Datalabs are a low-cost way to measure service impact from data that has already been collected by government. They have significant potential to generate greater value from existing data and to be a catalyst for service providers to lift their data literacy and service standards. They also help ensure that funds are allocated to ‘what works’. The Commonwealth government could invest in data labs in order to overcome barriers to access and utilisation of data in the social impact investing market.

Datalabs enable service providers to know their clients’ outcomes by accessing de-identified data that is held by Government (e.g. reoffending rates). They enable funders and providers to understand their service impact by comparing client outcomes with a matched comparison group. Datalabs also help to overcome both access issues but also cost and capability barriers to impact assessment by providing service providers with access to low-cost data analytics. Currently, if a service provider can collect the necessary data, services for evaluating causal impact typically cost around \$100-\$200k. In contrast, the UK pilot is providing access to client outcomes and a report on comparative impact for approximately \$5k per program – a fraction of the cost of bespoke evaluation services.

The mechanics of a Data Lab are simple and involve four steps:

- Service provider submits client names to the Data Lab along with other identifying information.
- Using data from relevant government department(s), the Data Lab provides de-identified data on clients’ outcomes (aggregated if necessary) to the service provider.
- The Data Lab provides key statistical analysis services (depending on the service providers’ priorities) including comparing the client group with a matched group.
- Results about the impact of the services can be made public to generate a body of evidence on the types of services and providers that are most effective in improving client outcomes.

While the Australian Bureau of Statistics currently operates a data lab for its own data sets, there is limited capacity elsewhere in government for these services. Data labs would have obvious applications at a Commonwealth level in relation to employment outcomes, and in justice and health for State Governments.

3.9 Investment Ready Social Enterprises

Social enterprises are organisations that trade in order to achieve a social outcome (see Figure 4). Improving employment participation for a marginalised group is a common impact model for social enterprises. Employment-focused social enterprises typically create flexible, supportive workplaces that provide a combination of training, long term employment and opportunity to transition to mainstream employment. Social enterprises are also the preferred workplace of some specific groups such as people with an intellectual disability who research suggests would rather work for a social enterprise than an Australian Disability Enterprise or a mainstream employer.¹³

Social enterprises are responsive to local needs, and can be targeted towards key cohorts of interest to the community and Government, such as refugees and recent migrants, people with mental health issues and workers affected by industry restructuring.

Appetite for SII in Australia has been growing but there isn't a strong pipeline of high impact 'investment ready' organisations. Multiple actions are needed to address this – including revenue supports – but there is also a role for the Commonwealth in supporting social enterprises to become 'investment ready' so that their impact can be scaled.

SVA has incubated and invested in some of Australia's leading social enterprises that create opportunities for people otherwise excluded from the workforce, including:

- Youth at risk (e.g. STREAT in Melbourne)
- Mental health (e.g. Vanguard Laundry in Toowoomba)
- People with a disability (e.g. Christie's Emporium in Mildura, Ability Enterprises in Toowoomba)
- Long term unemployed (e.g. Industry Employment Initiative, e-waste recycler PGM Refiners)

Case Study: Vanguard Laundry Services

Vanguard Laundry Services (VLS) is a start-up non-profit commercial laundry based in Toowoomba and will employ up to 40 people with mental health issues each year and will also operate an industry-linked career centre for a further 40 people per year by partnering with local businesses.

SVA worked to help deliver the Vanguard Laundry social procurement deal through partnering with St Vincent's Hospital and the Toowoomba Clubhouse. Luke Terry, an experienced entrepreneur, had a vision to open a commercial laundry social enterprise in Toowoomba and saw the business as an opportunity to support the local community by employing people with mental health issues.

SVA gave Luke strategic and commercial advice about the feasibility of the business to take the concept from 'idea to built.' SVA was also instrumental in raising \$6 million of capital from a blend of philanthropy, government, local investors and bank finance to establish the business. Financial close was achieved in June 2016 and the laundry started operations in December 2016.

As mentioned previously, SVA also supported First Australians Capital (FAC) which is an Indigenous-led organisation with a vision of building a new economy driven by First Australians. FAC will provide concessional capital and capability support to Indigenous social-purpose enterprises and social

¹³ Meltzer, A et al, 2016, 'What do people with an intellectual disability think about their jobs and the support they receive at work? A comparative study of three employment support models', Social Policy Research Centre, UNSW.
https://www.sprc.unsw.edu.au/media/SPRCFile/Comparative_study_of_three_employment_models.pdf

entrepreneurs including capacity building, access to networks and development finance, with dedicated relationship management to build economic self-sufficiency within Indigenous communities and help drive a new economy in Australia. Indigenous businesses are 100 times more likely to employ Indigenous people and therefore supporting the growth and prosperity of Indigenous business is a powerful driver to tackle social disadvantage and create transformational systemic change.¹⁴

Providing appropriate support to earlier stage social enterprises will be the key to helping them access both finance and significant social procurement contracts that are available. Accelerators such as Social Traders play an important role in nurturing early stage organisations, whilst venture philanthropy and more recent initiatives, such as NAB's \$1m Impact Investment Readiness Fund, provide the funding for early-stage organisations to access professional services necessary to become investment ready (see Figure 2). However, in order to capture the full impact investment opportunity, Australia will need to focus on investment readiness at a much larger scale.

One highly successful government policy in this area has been the UK Government's Investment and Contract Readiness Fund (ICRF). This Government grant program supported social ventures to build their capacity to be able to receive investment and bid for public service contracts. The ICRF helped social sector organisations acquire the strategic, finance and legal skills they needed to raise investment and compete for public service contracts. A 2015 review of the ICRF program found that for every £1 spent by government on this Fund, it unlocked £23 of contract value¹⁵ and noted that 'in one deal alone, Empower Community Management raised over £10m in investment'.¹⁶

More recently, the UK Cabinet Office, Big Society Capital and Big Lottery Fund have jointly established the Access Foundation, a £100m foundation aimed at helping early stage social enterprises and charities access finance. The Access Foundation will deliver support via a Growth Fund (providing matched loan and grant capital up to £150,000) and its capacity building programs.¹⁷

A similar Government fund in Australia could provide the necessary capacity building tools in order to support the growth and sustainability of social enterprises around the country. Such a centre could contribute to the wider social enterprise ecosystem by sharing case studies, tools, contributing to key events and common ecosystem platforms which provide greater information and access to all interested parties. Figure 11 demonstrates where the gap currently exists in Australia and where investment is required.

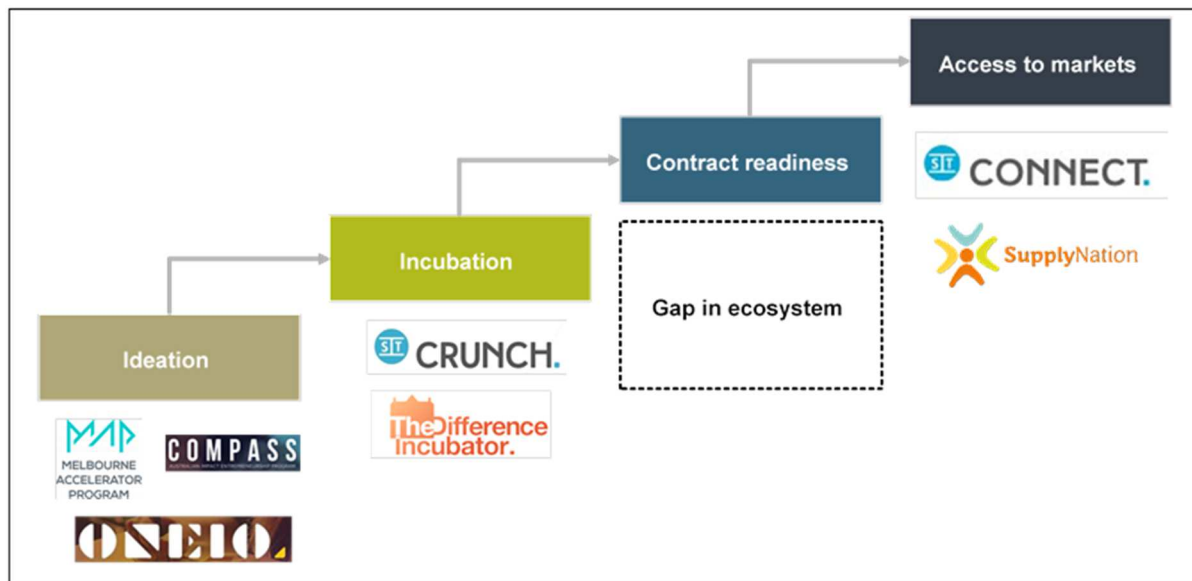
¹⁴ Hunter, B 2014, Centre for Aboriginal Economic Policy Research, Australian National University, unpublished analysis of data from Industry Capability Network Queensland.

¹⁵ Ecorys UK on behalf of UK Cabinet Office, *In Pursuit of Readiness: Evaluation of the Investment and Contract Readiness Fund*, 2015, page 11.

¹⁶ Boston Consulting Group, *Ready, willing and able: an interim review of the Investment and Contract Readiness Fund*, 2014, <https://www.gov.uk/government/publications/investment-and-contract-readiness-fund-interim-review-report>

¹⁷ <https://access-socialinvestment.org.uk/>

Figure 11: Social enterprise ecosystem in Australia



3.10 Social Procurement and generating demand

Social procurement is the innovative use of business and government purchasing power to create social value. Social procurement contracts are typically issued by either government or corporates, and include consideration of social factors – such as employment of disadvantaged groups – in the tendering process.

This can underpin demand for the products and services supplied by social enterprises, in which Impact Investors can then invest. For example, the Commonwealth Government has committed to place 3 per cent of its procurement contracts with Indigenous suppliers which is an estimated 1,500 contracts or \$135m each year.¹⁸ This will create large working capital needs, and hence impact investing opportunities, for winning bidders.

Yet the social procurement opportunity is much broader – both in terms of the range of potential procurers (all levels of government and in the corporate world) and suppliers (could be used to stimulate a range of social enterprises targeting various issues, such as long-term unemployed or youth at risk). In the UK, the Social Value Act is a relatively new law that requires that commissioners of public services consider social impact factors in tendering processes and not just focus on price.¹⁹ Social procurement in the UK has fuelled the growth of social enterprise champions such as the HCT Group, a social enterprise that operates many of London’s red buses, providing 20 million passenger trips every year.²⁰

Australia could further develop social procurement by using government purchasing power to create social value. Many Australian states are in the process of developing social procurement strategies and targets that include not just Indigenous business but also social enterprises, including Victoria, NSW and Queensland. In Victoria, infrastructure projects alone are expected to create up to \$500m

¹⁸<http://www.nigelscullion.com/media+hub/Coalition+procurement+policy+supercharges+Indigenous+businesses>

¹⁹ UK Government, Social Value Act: information and resources, <https://www.gov.uk/government/publications/social-value-act-information-and-resources/social-value-act-information-and-resources>

²⁰ <http://www.hctgroup.org/>

of revenue for social enterprises in the next six years and has the potential to create thousands of jobs for people experiencing disadvantage.²¹

Combining increased use of social procurement with highly leveraged investment and contract readiness funding will be a highly efficient way to stimulate growth in social enterprise, impact investing and the delivery of improved social outcomes.

²¹ SVA and Social Traders estimate; based on social procurement policies across ~\$25B Victorian infrastructure projects including Level Crossing Removal Project, Melbourne Metro Tunnel and Western Distributor Project

4 Regulatory barriers

4.1 Structural Barriers to Impact Investment

There is a growing number of Private Ancillary Funds (PAFs) being established in Australia as well as an increase in the size of those already established and these entities have significant impact investing potential given their predisposition to achieving positive outcomes with their capital. This was demonstrated by those looking to participate in the NSW SIB trials, the Aspire SIB and the SEDIF funds.

Uncertainty around the classification of a PAF as a sophisticated or professional investor has in some cases been an impediment for otherwise willing investment funds to make impact investments. It would be helpful to remove this concern and allow a PAF to be considered a sophisticated investor where any director of the PAF (or its trustee company) involved in the investment process meets such a test.

Clarity is also needed to ensure PAF trustee directors are comfortable that the fund is allowed to invest in a product only available to sophisticated and professional investors. As noted in the Discussion Paper, the Financial Systems Inquiry identified potential issues for PAFs around the application of the “control” criteria in the relevant section of the Corporations Act.

SVA recommends that the Corporations Act 2001 be amended to add a new section which provides that an ancillary fund satisfies both the ‘sophisticated investor test’ in s708 and the ‘wholesale client’ test in s761G of the Corporations Act 2001, if either of the following criteria are met:

- The fund has assets of at least \$2.5 million or has had income of at least \$250,000 in each of the past two years, as evidenced by its audited financial statements or a certificate from an accountant – this would apply to both PAFs and PuAFs (Public Ancillary Funds); or
- At least one director of the Trustee, who personally satisfies both the ‘sophisticated investor test’ in s708 and/or the ‘wholesale client’ test in s761G of the Corporations Act 2001, agrees to the investment as evidenced by the Trustee’s minutes – this would only apply to PAFs.

4.2 Principle Sharing of Risk

Trustee directors, including PAF Trustees, have a strong focus on prudential responsibility. Measures to reduce the downside risk of social impact investments, other things being equal, are likely to increase the appetite more than an equivalent increase in expected return (see Figure 4). Returns are also constrained particularly where linked to Government outcome payments.

To this end, where a social impact investment issued by an entity that may not have DGR status (eg. the trustee of a charitable special purpose unit trust that provides a benefit to an eligible DGR entity) ultimately fails, we recommend the application of the same treatment as is currently provided where a guarantee is called (Guideline 19.3 Example 6) and the component of the investment written off counts as a distribution of a PAF. This provision of benefit to an eligible DGR is consistent with the purpose of PAF deeds and therefore could be effected by a further example under Guideline 19.3 after Example 6.

SVA also recommends that a new Example be added to Guideline 19.3 showing that the write-off of an investment made either directly to an eligible DGR or indirectly via a structured investment trust for the benefit of an eligible DGR, may be treated by a PAF as a distribution.

5 Conclusion

SVA's believes the Commonwealth Government can play a significant leadership role in fostering and growing a diverse social impact investing market in Australia which will achieve measurable and desirable social outcomes for the Australian people.

On this basis, SVA has recommended a series of initiatives where the Government could support the Australian SII market to grow by developing a national social impact bond capability; new social and affordable housing finance mechanisms; improving data capability and boosting the investment readiness of social enterprises as well as regulatory changes.

SVA would welcome further discussions with the Government about the rationale and proposed recommendations on any of the above mentioned initiatives.

6 About SVA

Social Ventures Australia works to improve the lives of people in need. Our approach focuses on understanding the structural causes behind persistent disadvantage, then finding and supporting the innovative approaches that can create systemic change.

In order to overcome disadvantage in Australia, we have focussed on initiatives designed to provide great education, sustainable jobs, stable housing and appropriate health, disability and community services. By offering funding, investment, and advice we support partners across sectors to increase their social impact.

We are a non-profit organisation established in 2002 by The Benevolent Society, The Smith Family, WorkVentures and AMP Foundation.