VCOSS Victorian Council of Social Service

VCOSS BRIEFING PAPER

Social impact bonds

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What are social impact bonds?

A bond is a loan which is used to finance a long-term investment. The bond issuer (usually a government) pays the borrower's interest throughout the term of the bond. The borrower then repays the bond on a set date.

Social impact bonds, also known as social benefit bonds or social investment bonds, are a relatively new type of bond that seeks to achieve positive social improvement with a financial gain. Investors provide the money (capital) to deliver a service.

If government savings are generated from achieving better outcomes then the government can repay the upfront investment and provide a return on that investment. They are 'a financial instrument that pays a return based on the achievement of agreed social outcomes.'[2]

They differ from traditional government bonds because the capital is repaid with interest only if social improvements are realised.

What are they used for?

Social impact bonds can be used for almost anything.

They have been used to develop and fund services aimed at preventing criminal reoffending for adults and young people, employing ex-prisoners, and the prevention of child abuse and neglect.

In 2016, the **Victorian Department of Treasury and Finance** requested proposals for social impact bonds for alcohol and other drug services and services to assist young people leaving out-of-home care when they turn 18.

In an environment of limited government funding and risk averse public services, social impact bonds could be used to develop innovative, preventive services, while traditional funding maintains crisis services.

Governments might be able to make savings as demand on crisis services is reduced as preventive services develop. If the preventive service is unsuccessful then no savings will be made but the government does not pay out the bond and the investors lose their money.

What do they need to work?

Social impact bonds need[3]:

- Robust outcome measures
- A clearly defined target group
- Significant government savings as a result successful intervention
- An issue perceived as a priority by the public sector and by investors.

[2] NSW Office of Social Impact Investment, 'Social Benefit Bonds', http://www.osii.nsw.gov.au/initiatives/social-benefit-bonds/ accessed 10 October 2016.

3 As outlined by The Chief Executive, Social Finance (UK), David Hutchinson and reported in Damien Currie, 'Social Impact Bonds a 'Game Changer For Australia', *Probono Australia*, 2012.

What are the benefits?

Social impact bonds are in their infancy and there is not yet sufficient evidence to assess their effectiveness.

Governments are seen to benefit because:

- Social impact bonds shift the risk of investment from taxpayers to private investors
- Bonds can provide resources for new preventive and early intervention services while government funding maintains existing services
- Bonds offer a way to achieve social policy goals without government expenditure unless the agreed outcomes are achieved
- The services the bonds fund can save the government money by lowering expenditure elsewhere.

Commercial investors may benefit by getting a return of their investment in a new market. Given the risk involved, the investors would expect a rate of return better than a traditional bond.

Community service providers could benefit by receiving funds for innovative services that can address a community need.

Multi-year funding allows service providers the time to plan and carry out longer-term projects. This means they are more likely to address the *causes* of problems and not just the *symptoms*—which is the problem with some government funded programs.

Community service providers could also be investors and so gain a financial benefit if the outcomes are achieved.

The community would benefit if new services are developed. These are often innovative and focus on early intervention rather than crisis services.

What are the risks?

Social impacts bonds are complex. Contracts are expensive and time-consuming to develop. Agreed outcomes, measures and targets need to be developed, often requiring new data collection and computer systems.

Getting the government, investors and the service provider to agree on all matters before services can commence requires time and persistence. Therefore, the time and cost of establishing the bond could potentially outweigh the benefits to the community organisation and government.

While social impact bonds seek to ensure financial risks are primarily borne by the investors, governments may be under political pressure to pay the bond even if the service does not reach its target but is relatively successful.

There is a substantial risk to the good reputation of the service provider if services fail to deliver the outcomes require by the contract.

Community organisations that are also investors in the social impact bond are exposed to the same financial risk as any other investor.

FURTHER READING

- **Social Ventures, ‘Social Impact Bonds’**
- **American Progress, ‘Frequently Asked Questions About Social Impact Bonds’**
- **Social Finance, ‘Social Impact Bonds’**

The Victorian Council of Social Service (VCOSS) is the peak body of the social and community sector in Victoria. This briefing paper was prepared by VCOSS Policy Advisor Dev Mukherjee.

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