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From Investment to Impact

The NFP Experience with Social Impact Bonds

Mowat NFP
THE MOWAT CENTRE'S
NOT-FOR-PROFIT RESEARCH HUB

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Ontario

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Introduction

The Social Impact Bond (SIB) is a new mechanism for funding preventative interventions focused on impact and outcomes. SIBs use private capital to fund programs that are not already provided through existing public policy and that have the potential to respond to complex problems and provide long-term savings to government. With only one SIB launched in Canada to date, the idea is new to the funding landscape and has inspired both optimism and skepticism within the not-for-profit (NFP) sector.

SIBs are a product of two important trends that have emerged in the provision of public services. The first is the move away from fee-for-service arrangements towards *outcomes-based funding and programming*. In the context of fiscal constraint, governments increasingly desire demonstrated value for public money spent on contracted public services. The result has been increased focus on directing resources to those programs and services that deliver the most positive social impact.[1] As these programs are evolving in different jurisdictions, there has been considerable experimentation to find what works for clients, providers and government.

The second trend is the growth of *social finance* in the form of impact investing. There is growing interest in what is known as "double bottom line" investing, characterized by a mix of for-profit investing and promotion of public benefit. Through a structured agreement with government to pay the returns to investors, SIBs are designed to provide this mixed social and financial return to investors.

However, questions and controversy surround the SIB model. Critics question whether they are not simply a new way to describe government offloading of social spending. Will better outcomes and cost savings actually be realized through the model? What do SIBs mean for funding to the NFP sector as a whole? Champions of SIBs argue the potential of the tool must be explored as it may offer a way of financing innovative interventions that have proven outcomes but that government is not yet funding. Can they offer a way to improve public programs by scaling successful interventions?

Given the first SIB launched in the UK in just 2010, the evidence is not yet available to determine their success, failure, threat or promise. While there are a number of technical guides and briefings that focus on SIBs, particularly for investors and government, there has not been the same focus for service providers. This *Sector Signal* evaluates SIBs as a potential opportunity for the NFP sector. It explores the early learnings from service providers being funded through SIBs in other jurisdictions and considers how SIBs might be shaped to realities in Ontario. This report is not meant to be a technical guide[2], but rather its objectives are to examine both the challenges and opportunities of the SIB model and encourage strategic conversations among not-for-profits, policymakers, and impact investors about how this model might best be adapted to strengthen the capacity of the sector to deliver outcomes.

RESEARCH METHODOLOGY

Research for this *Sector Signal* included a review of existing literature and a series of in-depth interviews with NFP service providers, funders, and policymakers who have direct experience with SIBs. Interviews were conducted with 22 participants during the month of May 2014.

1 See Gold & Mendelsohn (2014) for an overview of outcomes-based funding and its associated policy challenges.

2 For more information on the SIB development process from the perspective of the service provider, See the *MaRS Social Impact Bond Technical Guide for Service Provders*, So & Jagalewski (2013).

1 The Signal

SIBs are getting a lot of attention in the NFP sector. In the face of declining sources of revenue, and a broader shift toward outcomes based programming and funding, discussion about how to fund preventative social services has increasingly included the SIB model.

Since the launch of the first SIB in the UK, governments around the world have started developing and launching SIB pilots. As of July 2014, there are at least 24 SIBs worldwide, with many more being considered at all levels of government.[3] To date, most of these have been launched in the UK, but Australia, Belgium, the Netherlands, the United States, and most recently Canada have all launched SIBs.

Interest in SIBs, as well as their driving factors, differs slightly depending on jurisdiction. Each SIB has been shaped by the political climate and the needs of the specific population it serves.

> SIBs are a response to payment by results, a way of making sure payment-by-results works for small organizations with few assets.
>
> –EVAN JONES, ST. GILES TRUST, UK

In the UK, SIBs evolved out of payment-by-results (PBR) government contracts and the emergence of a government-supported social finance market. NFPs were struggling to access funding in an environment marked by broad and steep funding cuts, and the shift toward PBR contracts forced NFPs to carry the financial burden and risk.[4] As a funding model, SIBs presented an opportunity to relieve NFPs of financial pressure while providing them with stable, multi-year funding under an outcomes-based programming model. In the UK, a key part of the landscape has been the creation of Big Society Capital, using funds from unclaimed, dormant bank accounts and funding agreements with major banks. The dedication of approximately £600 million for social investment served to jumpstart the social finance market and supported the launch of SIBs.

3 For a list of SIB projects, see UK Cabinet Office Knowledge Box http://data.gov.uk/sib_knowledge_box/case-studies-existing-sibs and Finance for Good SIB Tracker at http://financeforgood.ca/social-impact-bond-resources/finance-for-good-sib-tracker/.
4 See Sheil and Breidenbach-Roe (2014) for a discussion of payment-by-results in the UK context.

In other jurisdictions, the shift to PBR contracting is not as established and has not been as significant a driver. In the US, for example, interest in SIBs is driven by:[5]

» Desire for evidenced-based decision-making processes to bring programs to scale

» Belief that bringing 'market discipline' to scale preventative social service delivery will improve social outcomes

» Desire to shift to multi-year funding approaches for preventative service delivery that are difficult to justify due to current budget structures and political attitudes toward public spending

The desire to shift to an outcomes-based policy framework, coupled with continued fiscal austerity, has meant that there is considerable interest in leveraging new money to pay for preventative services.

SIBs are frequently compared to Public-Private Partnerships (PPPs or P3s), where long-term infrastructure costs are 'amortized' over a longer period of time under a 'buy now, pay later' model. P3s allow the public sector to define the desired outcomes, transfer risk to the private sector, and allow the partner to develop the best solution to deliver those outcomes. P3s are used primarily when public infrastructure is needed but would not otherwise be built due to fiscal constraints.

A parallel can be drawn to SIBs, where the contract is used to fund preventative social services that are needed, but not covered by existing funding—effectively a P3 for people, as one interviewee noted. In this sense, a SIB may be considered a 'P4'.

In Canada

In Canada, interest in SIBs is growing fast. The country's first SIB was announced in Saskatchewan in May 2014. Sweet Dreams is a $1 million dollar program designed to provide supportive housing for at-risk single mothers and their children.

Saskatchewan is not the only jurisdiction that is pursuing a SIB. At the federal level, the government announced a Call for Concepts on Social Finance in 2012, and in 2013

5 See Liebman (2014) and US Senate Budget Committee (2014).

released its report *Harnessing the Power of Social Finance*. In Alberta, the development of the $1 billion Social Innovation Endowment signals that SIBs may soon be on the horizon. Nova Scotia and British Columbia have also publicly expressed interest in the SIB model.

In March 2014, the Ontario government announced a call for proposals on SIB ideas, and a concurrent RFP for expert consulting services to help develop them. Organizations were invited to submit proposals for SIB ideas around issues of housing, youth-at-risk, and employment. The announcement aligns with the province's 2013 *Social Enterprise Strategy* that committed the province to piloting one or more SIBs under the 'Creating a Vibrant Social Marketplace' pillar.

Taken together, these examples illustrate a high level of government interest in examining the model. At the same time, there is an emerging impact investing market that is looking for opportunity. The 2014, MaRS *State of the Nation: Impact Investing in Canada* report highlights a growing and increasingly sophisticated impact investing community that is interested in pushing new deals forward. Within this community, there is a drive to establish the market and to develop proof of concept for the SIB model.

Why Does it Matter?

Ultimately, the creation and success of a SIB will depend on the service provider. If the focus of the model is to improve outcomes for complex social problems, NFPs have an important role to play in shaping how programs will be delivered and outcomes understood.

Since SIBs are an emerging tool, the evidence and lessons from these early pilots are just now being collected. This creates an important opportunity for the NFP sector to define the role of service providers in the model as it evolves in Ontario. In each jurisdiction where SIBs have been launched, the drivers and characteristics have been different and shaped by the local context. Not-for-profits need to be informed and engaged with the results of these pilots to lend a critical and informed perspective on how this new model might impact the sector.

> "I don't think the NFP sector should wait to see how the government frames it. They should be in the room with government and investors to shape how it's going to work. It's too complex and important to wait until it's been crafted, and to just treat it as a regular procurement exercise."
>
> —CHARLOTTE RAVENSCROFT, NCVO, UK

EGADZ "SWEET DREAMS" PROGRAM— CANADA'S FIRST SIB

In May 2014, Canada's first SIB was announced. The agreement between Saskatoon-based NFP, EGADZ, the Saskatchewan government, and two philanthropic investors, is designed to provide housing with supportive services for at-risk single mothers and their children. The program aims to provide support to families at-risk and decrease the need for foster care interventions from Child and Family Services. EGADZ expects to house 8-11 families at any point in time. Clients will participate in the program for a minimum of two months to a maximum of two years, depending on the level of support required.

In comparison to SIBs in other jurisdictions, where participants reported intensive negotiation processes that lasted up to 24 months, the EGADZ SIB was negotiated in 7 months and is characterized by a simple payment structure. The bond is structured as a 4-year intervention model with a 5-year payout term. The joint development phase focused on identifying a goal that was simple and easy to measure: costs avoided from housing children in the foster care system.

The process was described by its partners as being an opportunistic and nimble response to a promising program that lacked funds. The Saskatchewan government was interested in the program proposed by EGADZ. After identifying a SIB as a potential funding model, government was able to reach out directly to potential funders. In this case, EGADZ, investors, and government already had strong relationships, and participants reported that the high levels of trust between the parties facilitated the process.

2 Defining the Opportunity

What is a Social Impact Bond?

A SIB is a mechanism through which investors provide multi-year funding to service providers to deliver a preventative intervention with the expectation of net savings to government. Government agrees to repay the investors' capital plus an agreed-upon return if the program meets its outcome goals. These investors can be traditional funding agencies such as charitable foundations, but may also be private institutions or pools of capital, i.e., banks or equity funds.

What are Social Impact Bonds Used For?

SIBs are intended to fund preventative services that already have promising evidence of effectiveness, and which align with broader public policy goals. Governments tend to underinvest in prevention, with most of their budgets being tied up in acute services. Fiscal constraints often make long-term, preventative investments difficult for government. SIBs offer new capital for services that would otherwise go unfunded. The hope is that savings accrued through the preventative intervention could free up funds to invest in further solutions.

At the same time, many NFPs operate small-scale programs backed up by high-quality evidence of their success. They do not have the resource base to scale-up service provision. SIBs offer this capital.

SIBs are not meant to replace traditional government contracting. They are a niche tool that will be useful for situations where capital can be leveraged to achieve these goals.

> Every side of the conversation between government, the NFP and the investors have said how much they've benefited; there's been a huge amount of learning about the other person's perspective.
>
> -RUTH LAWRENCE, KPMG AUSTRALIA

How Does a Social Impact Bond Work?

A SIB can be initiated in several different ways. Just as in a traditional contracting arrangement, a government ministry or department may set broad goals for the bond and call for proposals from potential contractors. Alternatively, a service provider (alone or partnered with an intermediary) may approach the government with a proposal.

Figure 1 shows the basic elements of a SIB. At its core, a SIB is an agreement between government, investors and service providers. Many SIBs also rely on external intermediary organizations—an independent organization that acts in the best interest of the deal overall. The roles and responsibilities of the intermediary function depend on the particular SIB[6] and may include, among others, engaging partners (government and investors), negotiating the SIB contract and model, and overseeing performance management. Usually, an outside organization will evaluate the results, though the intermediary, government, or even NFP itself may fulfill this role.

A SIB is an investment of set length (usually between 3 to 10 years) that promises a variable rate of return to investors. The rate of return depends upon how successful the program is at meeting its contracted outcome goals, (e.g. reducing youth unemployment or recidivism). Since the service provider is not expected to repay the investment, they gain stable funding and can focus on program delivery. However, SIBs demand a lot of preparation and negotiation to make sure the goals are appropriate, reasonable and well-measured.

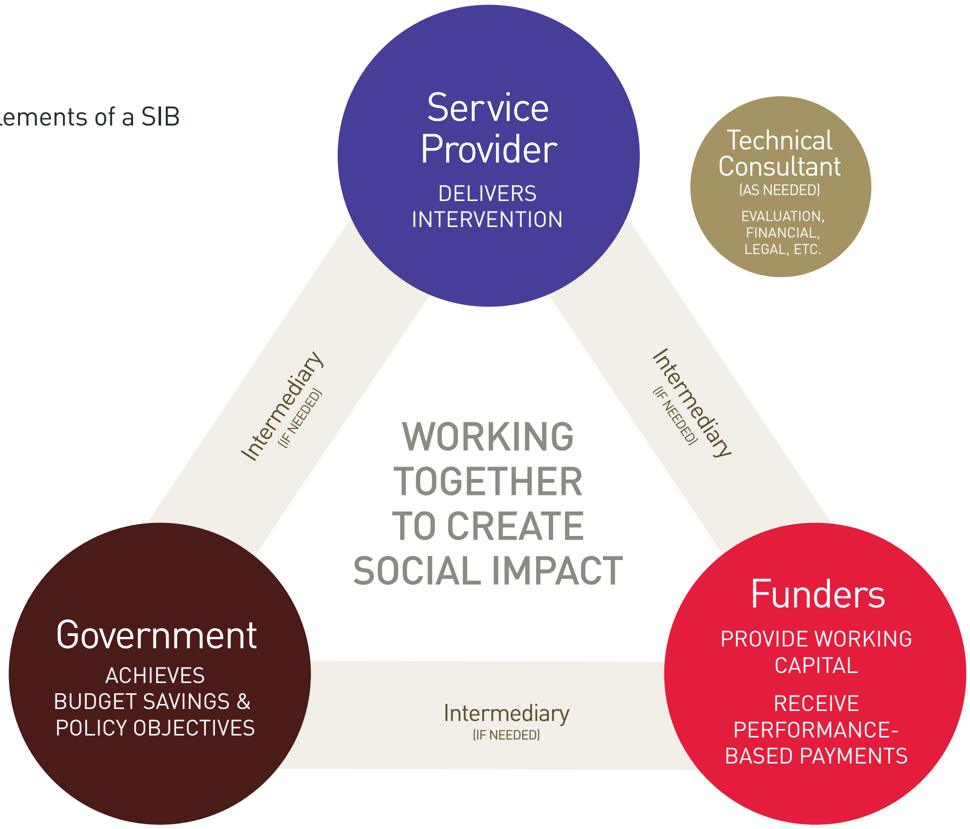
SIBs differ markedly from ordinary service contracts. Before considering a SIB, NFPs should be aware of two things:

1. The contract is generally negotiated after a successful bid has been placed

This joint development period is crucial for establishing the rigorous data, measurement practices, and repayment model necessary to satisfy all parties. This step can take anywhere

6 For examples, see Social Finance UK at http://www.socialfinance.org.uk/work/sibs. In other cases the government contracts directly with the NFP, as in the United Way SIB in Utah. In these cases, the duties undertaken by the intermediary may be divided between the government and the NFP in a number of ways.

FIGURE 1
Structural Elements of a SIB



from six months to two years. As more SIBs are negotiated and more is learned about what makes a SIB successful, the preparation and negotiation period may become shorter. In this sense, Ontario stands to benefit from experience of SIBs in other jurisdictions.

2. A SIB is often subject to more detailed project management by intermediary organizations who balance the interests of investors, government and the NFP

Often this involves intermediaries taking a closer interest in day-to-day service delivery, project management and evaluation. Some NFPs described this relationship as challenging. And yet, NFPs who have gone through a SIB often feel that governments and funders have emerged from this close interaction with a much better understanding of the intervention itself and its requirements.

What About Innovation?

Some of the early literature argued that SIBs would encourage innovation because outcome-based funding schemes focus on results rather than the means by which results are achieved. Some even argued that innovation would be a primary motivation for adopting the SIB model.[7]

However, this argument should be treated with caution. Investors, particularly private-sector investors are motivated by the promise of return, and generally want to know the track record of an investment. The fact that SIBs are a new concept makes the need to establish their performance even more important. Since so few have been issued, they generally must rely on evidence of a program's past effectiveness to mitigate risk for investors. The program may be innovative, but it is not the SIB model itself that creates the innovation.

Well-designed SIBs may have a small portion of their budget set aside for innovative practices, and allow the parties to agree to adjust the program in response to lessons learned over the course of the bond. A 2014 report by Rand on Phase 2 of the HMP Peterborough bond found that the innovation lay in the flexibility of the funding model to allocate funds as needed, local management of the pilot, and the ability to adapt the service as more information was learned and collected through the SIB.[8] However, early experiences suggest that SIBs do not primarily incent service innovation; rather, they are innovative because they bring funders and service providers together in a new way that gives clients access to services they might otherwise have been denied. In fact, it is up to the negotiating parties to make room for further innovation in the structure of the bond.

7 For example, see Cohen (2012).

8 See Disley & Rubin (2014) for an in-depth discussion around perceived innovation in the HMP Peterborough bond.

> There is a huge tension between having a program that is innovative, and having a program with a strong evidence base. A bond is about investing in an outcome. Investors want to put their money where it has a high likelihood of achieving success.
>
> –RUTH LAWRENCE, KPMG AUSTRALIA

Where is the Risk?

A key element of a SIB is managing risk. The SIB brings investors to the table with the promise of return by the government if the outcomes are achieved. A financial return is provided based on the outcomes delivered. However, if the outcomes are not achieved, it is the investor that will not be paid by government. In this way, the service provider is protected from the financial risk, but still bears reputational risk if the program is not successful. Government is protected from paying for an unsuccessful program. However, the challenge of a failed SIB for all players is the reputational risk of the tool itself and the implications for future impact investing opportunities.

New Money at the Table

One opportunity presented by SIBs for the NFP sector is their potential to connect the sector to new resources. The degree to which they fulfill this promise has yet to be fully determined and there are three main concerns around this notion: The first is that government will back away from its current obligations to social programming, leaving existing programs vulnerable. Second, there is concern that the money on the table is not actually new, but rather a diversion of existing funds into SIBs. Thirdly, there are concerns about the viability of SIBs as an investment product and the overall strength of the impact investment market.

So far, evidence does not yet fully support or disprove these concerns. First, early evidence does not show a marked shift away from government investment in social programming. The second question of new money at the table varies across jurisdictions. In Australia, there is some evidence that the bonds attracted new investment from impact investors who would have otherwise used the funds for commercial investing purposes.[9] In the US, there has been investment from private investors but there has also been a trend toward philanthropic donors providing financial backstopping for the programs if they fail. For example, when Goldman Sachs invested $9.6 million in a program designed to reduce recidivism for young men leaving Riker's prison, Bloomberg Philanthropies provided a loan guarantee of $7.2 million should the program not meet its goals.

In the UK, the market to date has generally been dominated by philanthropic foundations. Mainstream investors have not invested heavily in SIBs due to challenges around lack of scale, the return not reflecting the risk, and a lack of track record around the investment model.[10] On the question of diverting money from philanthropic investors, the results are mixed. Some funds have been drawn from endowments, which may be seen as new money, but funds have also been drawn from granting streams. Arguably these charitable investors are diverting money into SIB investments that would have been otherwise available to NFPs in the more accessible form of grants. In the Canadian context, the regulations around charitable investments permit foundations to apply their disbursements to program related investments, which may be an incentive toward using these funds, rather than tapping the investment opportunity of endowments.

> In the UK, SIBs have not yet brought significant new money into the sector. Until now, charitable investments for SIBs have been drawn broadly from the program side. However, social investment has meant that money has been recycled into the sector, so in some ways that's increasing the pot.
>
> —RICHARD JENKINS, ASSOCIATION OF CHARITABLE FOUNDATIONS, UK

Finally, the viability of the Canadian impact investor market is not yet clear. In a 2014 market study released by the MaRS Centre for Impact Investing, the size and scope of the market was not definitive but showed growing interest in the concept.

9 See KPMG (2014) p. 31.
10 See Kuznetsova & Palumbo (2014) p. 3.

3 Getting to a SIB

The following section looks at five critical elements of the SIB process as they impact participating NFPs. SIBs are not for every organization. Based on the experiences of participants and drawing from relevant literature, this section highlights potential opportunities and challenges for NFPs pursuing SIBs:

» Negotiating the Deal

» Cash Flow and Resources

» Ability to Deliver on Mission

» Evaluation and Data Monitoring

» Ability to Shape Policy

Overall, both the literature and the direct experience of NFPs underscore the importance of preparation and awareness going in. NFPs considering a SIB need to be realistic, know the capacities of their organization, the limits of their intervention model and what opportunities a SIB might offer their organization. SIBs are not suited to all NFPs or all program ideas. A SIB is a niche funding instrument that demands particular skills and capacities. Governments and other stakeholders must be aware of these challenges going in, and work to strengthen and facilitate the process for NFP partners.

Negotiating the Deal

For the delivery of social and human services, NFPs traditionally rely on service delivery contracts with governments, grants from charitable organizations such as foundations and trusts, and individual donations. As a result, many NFPs have developed the business and negotiation skills to make their case to these funders. However, securing investor backing and negotiating a SIB pushes NFPs into the world of finance, where they usually have little or no experience. The level of support needed from outside partners or through investment at the staff level will depend on the NFP's pre-existing data, finance, and contract negotiation skills.

To date, the negotiation of SIBs has required a high level of resource dedication and staff time in order to reach an agreement and begin service delivery. Though the length of time varied based on the SIB, interviewees almost uniformly described the negotiation process as being very intensive.

For SIBs in New South Wales, Australia, the HMP Peterborough bond in the UK, and the Rikers Island SIB in New York, the negotiation/joint-development phase processes took 18-24 months to complete. The *Evaluation of the Joint Development Phase of the New South Wales Social Benefit Bonds Trial* (2014) by KPMG in Australia found that on average, the two bonds required 11,712 labour resource hours from service providers, government agencies and associated advisors over the 2 years. Of that, 2,984 labour hours were attributable to NFP providers plus an additional 1,144 labour hours on the part of 'Service Provider Advisors'.[11] In these cases, NFPs engaged in the process had full-time staff resources dedicated to the project. One NFP reported having a staff member fully dedicated to working on the advancement of the SIB file for over 2 years.

> "I advise NGOs that they need to be prepared to make an investment equal to around 2 FTEs to get a SIB off the ground. They also need access to skills covering financial modelling and experimental design, plus detailed knowledge of the current government system and how NGO services operate on the ground."
>
> —JOCELYN BELL, THE BENEVOLENT SOCIETY, AU

However, the timelines and level of resource commitment required on the part of NFPs has not been uniform. In cases where all parties are familiar with each other and place emphasis on a simple, streamlined process and outcomes, the negotiation phase may be shorter. Other SIBs have been finalized on shorter timelines but still pursued a very intensive process.

11 KPMG (2014) evaluates the joint development process from the two Australian SIBs and presents key lessons learned from the trials. Page 29.

For one interviewee, the time frame between the call for proposals and commencement of service delivery was very short. As a result, the negotiation and due diligence phase of the contract was completed over the course of 6 months. This required a very high level of resource allocation on the part of the NFP. They had to pull staff off other projects to respond to the high level of scrutiny required for financial due diligence. The service provider suggested that in future SIBs, this process could be better coordinated and planned between partners to ensure that NFPs are not burdened with multiple requests for the same information and paperwork.

In terms of the resource requirements needed to make the deal, NFPs reported that it was not only the financial metrics that required intensive negotiation. Finding quality baseline data and outcomes negotiation required a large amount of capacity on the part of NFPs. In the negotiation of a SIB in Massachusetts, the service provider, Roca, reported that data matching was time consuming. As a provider, they had been doing an intensive data tracking process on the outcomes of their own work for over 7 years. However, despite their high capacity for data monitoring and evaluation, considerable time was spent waiting for the data matching and outcome metric negotiation process due to the poor quality of data available on the government side.

So far, the complexity of the negotiation phase has had two major effects:

1. Larger NFPs have been more successful in responding to calls for the development of first-generation SIBs.

They are more likely to have strong back-office supports and to have recruited senior management—or special consultants—who have the requisite skills in finance and business.

2. Intermediary organizations have been helpful for smaller NFPs who feel they need support, either on the financial negotiation or data collection front.

Intermediary organizations offer financial skills and experience that may be missing. One NFP spokesperson emphasized that the contract negotiations between government and investor stakeholders were very tough, and without the intermediary, the service provider would likely have been taken advantage of during the process.

The negotiations of first-generation SIBs have featured high transaction costs, particularly in terms of time invested. Because of this, they may well have excluded potential innovative partners in the sector.[12] However, there is an opportunity for Ontario to build on the investment already made in other jurisdictions, streamline these negotiation processes, and avoid reinventing the wheel. In the US there is a commitment to developing the field of open-source contracting, so that the documents produced by these long negotiations become part of the public domain[13]; Ontario should follow this example as well as learn from the information shared in this way.

Cash Flow and Resources

One of the more straightforward benefits of SIBs for service providers is the promise of long-term, stable revenue provided up front. SIBs are currently structured for service interventions that last from 3 to 4 years, with the SIB contract itself lasting most often between 5 to 7 years. The financial risk is borne by investors, in exchange for the promise of a modest return if the project meets or exceeds expected outcomes. This means that NFPs who secure a SIB contract are provided with funding up front and do not face a clawback of funds for not achieving expected outcomes.

This transfer of financial risk is partly in response to, and an improvement upon, other forms of outcomes-based funding contracts. In many of these, NFPs must assume financial risk, either by providing services up-front that might never be paid for, or by operating under the threat of clawbacks. As a consequence, this type of outcomes-based contract is often limited only to the few large NFPs with the resources to assume such risk. SIBs do not require a financial commitment from the service provider, with the exception of the development costs described above. However, NFPs stress that SIBs do carry substantial reputational risks for them.

There has been some variation around who assumes financial risk under the SIB model. In one case, the service provider chose to shoulder more of the risk in order to increase the appeal of the SIB to investors. Roca, in Massachusetts, volunteered to contribute 15 per cent of the capital at-risk in their SIB as a gesture of confidence in their

12 For example, Owen & Marvel (2013) argue that there is a natural division within the NFP sector between small shops that innovate many new program ideas, and large shops that have the fiscal and human resources to bring programs to scale.
13 In Australia, the implementation agreements for the two NSW SIB trials are available on the NSW Treasury website. However, they have not published the Operations Manual that contains the detail of the measurement framework. See, NSW Treasury (2014) at http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds.

program.[14] The investment on the part of the service delivery partner has set a contentious precedent for future SIBs. If this becomes a popular model, it might ignite debate over whether SIBs are only accessible to organizations with the ability to contribute financially. In Australia, the government itself has been an investor in SIBs. This model re-introduces some of the financial risk for government, but may increase investor appeal by showing confidence in the program, and that government is on board to ensure success and think about the future of the program.

An open question in the design of existing SIBs is whether they can encourage front-line service innovation through flexible budgeting. In the HMP Peterborough bond, a small amount of funding (7 per cent of the budget) was actually set aside for testing new ideas as the project progressed. The arrangement was seen positively, but interviewees were cautious about its future potential. If bidding for SIBs became very competitive on cost, this budget item could easily be squeezed out.

Ability to Deliver on Mission

Can SIBs enable NFPs to deliver on their mission on a larger scale and with greater impact? Yes, but it is not for everyone. Interviewees found that ability to deliver effectively on their mission and to take their work to scale were capacities that were both demanded by and enabled through the SIB process.

In order to be successful in a SIB, or any outcomes-based funding program, an organization must already be performing at a high level in terms of service quality and outcomes. Many of the NFPs that were interviewed highlighted the importance of making a realistic assessment of the organization's current capacity to deliver outcomes. In some cases, organizations found they were not as prepared as they should have been for the increased level of activity and skills required to deliver and monitor their programs under a SIB. This gave the organization a steep learning curve at the beginning of the bond and in some cases, initial results suffered. Though interviewees reported that this improved rather quickly, many felt that NFPs considering a SIB would benefit from rigorous self-assessment at the outset.

Overall, service providers expressed satisfaction with delivering a service that was actually focused on outcomes. Organizations reported more flexibility to adjust the service to meet client needs. Staff were able to deliver tailored interventions that had been previously constrained under more prescriptive funding models, including the ability to include non-traditional interventions into programs.[15] Others reported the ability to use resources to provide more individual service (such as making arrangements for a client on probation to attend an out-of-town funeral for a family member). In other cases service providers had the ability to stop delivering aspects of their services that were proven to be unhelpful as a benefit of the more open-ended structure.

One factor that seems to affect flexibility in service delivery is the relationship that the NFP has with its intermediary and other partners. Some have argued that SIBs will allow NFPs to have greater "freedom on the front lines" to deliver their service in a way that works for the organization. To date, the results of this ability have been mixed.

One challenge reported by providers was that they sometimes felt the intermediary organization tried to "micro-manage" areas of the project even though the intermediary lacked expertise in the field. NFPs bring the expertise and knowledge regarding service delivery to the SIB project and the structure of the contract should recognize this fact. Interviewees identified the need for partners in the process to have the ability to focus on their individual strengths (service providers on service delivery and intermediary organizations on finance and stakeholder relations). This highlights the importance of clearly defined roles and responsibilities for all partners involved. In negotiating the contract, NFPs should ensure that they have the ability to contribute their expertise in effective ways and are able to focus on delivering the service to clients.

Interviewees also reported that a high level of trust between the parties involved was necessary to achieve a successful balance of strengths. One interviewee stated that an ideal situation would include pre-existing relationships between parties or a jointly developed SIB proposal.

14 Under this deal, Roca was able to contribute $3.2 million. To date, $1.9 million of the money has been granted to Roca from foundations and it will be able to use the return expected from the SIB to re-invest in the organization. For more information on the terms, see Commonwealth of Massachusetts et al. (2014).

15 For example, one provider working with at-risk youth was able to include horse-whispering in their program. This refers to an activity where youth learn responsibility and emotional/behavioural regulation by working with horses. The provider noted that it was an aspect of the program that would not have been funded under a more traditional funding model.

Evaluation and Data Monitoring

SIBs require a great deal of attention to data collection and evaluation; in fact, meeting these requirements is often the biggest challenge to getting a SIB off the ground. However, the process of improving data and evaluation practice was often the most significant and lasting benefit cited by NFPs who are participating in a SIB.

> "It's an amazing opportunity to learn how effective you are, to focus on and improve your service. That was definitely The Benevolent Society's biggest motivation for doing a SIB."
>
> –JOCELYN BELL, THE BENEVOLENT SOCIETY, AU

There are a number of challenges in evaluating SIBs. Most NFPs have limited capacity to collect data on service user outcomes; often this has resulted in SIBs being awarded to very large service providers with in-house research teams. The evaluation challenge has also exposed the lack of capacity around data collection and access in many areas of government. Since these gaps have long been frustrating for service providers, some NFPs saw this exposure as a side-benefit of the SIB process.

Another challenge is deciding on appropriate outcome measurements. For a SIB, not only must the outcome metrics be clear and quantifiable, they should also be straight-forward enough that investors—who often have limited understanding of social policy or social service interventions—can understand and feel comfortable with them. They must also be sure to choose evaluation methods and metrics that limit perverse incentives. In existing SIBs the strong preference has been for easily quantifiable measures. For example, did the client finish high school within 3 years? Did they find a job? Did he or she return to prison within a year? How many days have been spent in a prison or a shelter?

NFP interviewees were divided on the best kind of measure. Some argued that a single payable outcome gave them lots of room to maneuver, granting them license to do whatever they felt was necessary to achieve the end result. Others viewed graded measures with multiple checkpoints of success as more likely to incent them to work with difficult clients.

The SRDC consulting report, *Applying performance funding to Essential Skills* (2013) highlights some best practices for designing performance measures that work. When identifying appropriate performance indicators it is important to avoid choosing indicators that are outside the provider's control, indicators that incentivize providers to 'pick winners', and short-term indicators that do not serve as proxies for long-term impacts.[16] The report argues that outcomes that measure gains (versus levels), frame performance along a continuum, and use checkpoints, or milestones, will be better for providers and discourage gaming, or unintended consequences.

Providers and intermediaries must also ensure that the amount of data collected is appropriate to the complexity of the program being evaluated. The data collected and tracked must be useful, not just collected for the sake of collection. If overdeveloped or under-resourced, service providers may spend a disproportionate amount of time collecting and inputting data and distract from service delivery.

Literature and interviews suggested that NFPs will benefit from having strong influence over measurement and evaluation in the negotiations.[17] This has not always happened, in particular where the service provider is brought into the SIB after these are determined. Where the service provider is included, smaller NFPs especially will need support during this process (whether from an intermediary, government, or third party support organization). One possibility to alleviate this challenge is to have NFPs come together outside of the SIB process and work together on best practices in measuring and valuing social outcomes.[18] Some suggest that NFPs could partner with universities to bolster their ability to identify rigorous metrics that serve their clients and their mission.[19] In fact, a number of jurisdictions have created "What Works" centres as institutional assets serving the policy community.[20] There is room within the Ontario landscape for such a centre that identifies opportunities for program innovation, supports evidence-based policy-making and builds the innovative program capacity of government, the not-for-profit sector and impact investors.

16 See Palameta et al. (2013) for more information on best practices for choosing outcome metrics and program design to avoid 'gaming'.
17 Gold & Mendelsohn (2014) p. 44.
18 Harji & Hebb (2010) call this a "lexicon of valuation."
19 See Joy & Shields (2013) "Social Impact Bonds: The Next Phase of Third Sector Marketization." *Canadian Journal of Nonprofit and Social Economy Research*, vol.4(2).
20 A What Works centre produces and disseminates research on public programs to policy-makers, supporting them in investing in services that deliver the best outcomes for citizens and value for money for taxpayers.

Ability to Shape Policy

What potential do SIBs offer for influencing government policy? Does the conclusion of a successful SIB create the opportunity to shift social policy by proving the value of innovative, preventative interventions? In theory, the savings to government from a successful SIB should make room to adopt smarter policy based on the results, even after investors are paid a return. So far only one SIB has been concluded (discussed below), so it remains uncertain how well SIBs can re-frame policy and program conversations.

AN UNEXPECTED WRAP-UP

The Peterborough SIB piloted reintegration services for those leaving prison after short sentences. After 4 years it showed positive results, improving on recidivism outcomes while the same outcomes were worsening in the country generally.[21] Recently, the UK government decided to privatise all probation services, a decision that will bring an early end to the SIB. Does this represent a "mainstreaming" wherein the Peterborough service provider (St. Giles Trust) changed government policy for the better?

Unfortunately this doesn't seem to have been the case. Though prisoners with sentences of less than 12 months will now receive probation services once released, the privatisation move resulted from competing government priorities, and was not a direct consequence of the learnings from the SIB. The services will be outsourced to one of a short list of providers.

This result underscores the vulnerability of SIBs, like any public policy or program, to the winds of political change. But in the case of SIBs, building investor confidence will be difficult if governments cannot resist dismantling successful SIBs in mid-stream.

Some social finance experts and NFP interviewees concluded that it is natural for successful SIB programs to be "imported" into traditional contracting arrangements. Once the savings and effectiveness are proven, they argue, the government should continue to pay for the preventative service through simpler and more direct relationships.

> "So I think we need to get used to the idea of Social Impact Bonds being a driver of innovation, which enables government to set benchmarks in areas where there hasn't been a lot of innovation for a long time, uses the result of the innovation to improve the policy, and the next generation of Social Impact Bonds in that area is then addressing a different problem."
>
> —SIR RONALD COHEN, MARS GLOBAL LEADERSHIP EVENT, MAY 5, 2014

While there is concern that SIBs may be used as a tool for offloading spending by government, they remain a policy instrument that will ultimately reflect the broader mandate of the government of the day. In fact, being involved with a SIB on the ground has had some benefits for NFPs regardless of the fate of any particular program. Being seen to be risk-tolerant and innovative (because of their involvement in a SIB) has opened doors for NFPs to access policy audiences who have a new interest in their work.

> "As a strategic move, [the SIB] couldn't be beaten. It's been the best party to be at, everyone is interested, everyone wants to know how it's going... it's given us lots of openings."
>
> —EVAN JONES, ST. GILES TRUST, UK

Some organizations found that a SIB represented a meaningful opportunity for their organization to influence public policy. For organizations that are delivering an evidenced-based and scalable intervention, a SIB may be an important vehicle for demonstrating value and pushing toward broader policy change. However, it remains to be seen whether this admittedly fashionable and clever idea can actually deliver on its promise and have a meaningful impact on complex and deeply entrenched social problems.

21 Social Finance UK (2014).

4 Recommendations

If SIBs are to fulfill their potential as a new source of funding and innovation, both the NFP sector and government will need to take steps to shape their development and implementation. The goal must be to strengthen the social policy and service delivery framework in Ontario.

For the NFP Sector

As a key partner in the delivery of SIBs, the NFP sector needs to be at the table to help shape what SIBs will look like in Ontario. To do this effectively, they need to negotiate with a strong sense of what their needs are and how to structure a contract that will provide them with the appropriate resources, funding tools and competencies to achieve success. This will involve:

» Conducting strategic self-assessments before going into the process. This assessment would include a review of organizational competencies (finance, negotiations, research and evaluation), ability to dedicate internal resources, orientation to impact, existing strategic partnerships, and a vision of taking the program to scale.

» Defining the roles and expectations of contract partners to ensure that NFP expertise is given appropriate space to focus on service delivery and achieving successful outcomes.

» Negotiating costing structures to ensure that new programs funded through SIBs are effectively resourced for success. Establishing fair and realistic costing at the outset will strengthen future negotiations for service delivery. In addition, reserving funds within contracts will allow for further innovation and learning as the SIB progresses. This should be built into the RFP so that it cannot be eliminated through underbidding in the competitive process.

For Government

As the enabling partner of a SIB, government has a role to play by ensuring the right conditions for development and demonstrating long-term commitment. This means creating the conditions for successful negotiation, building a strong evidence base, and ensuring that the process leads to better public policy. This process should include:

» Providing access to resources for service delivery partners once the negotiation phase begins to ensure that providers that have innovative ideas are able to negotiate SIBs effectively. Support during this period will prevent service providers from diverting scarce resources from existing demands.

» Promoting openness and transparency and reducing future transaction costs of SIBs by ensuring that negotiated contracts are shared openly by default. Open contracts from other jurisdictions may provide a useful starting place for building a made-in-Ontario template.

» Ensuring that the outcomes metrics chosen reward real impact. Indicators that incentivize providers to 'pick winners', and short-term indicators that do not serve as proxies for long-term impacts, are detrimental to the community, providers, and policymakers.

» Investing in better evidence and measurement to support promising opportunities for program innovation and evidence-based policy-making. For SIBs to deliver on their promise, a strong evidence base of best practices and lessons learned is needed.

» Establishing a policy working group at the beginning of the SIB process that convenes the relevant stakeholders, including service providers, to learn from the results of the SIB, and identifies policy opportunities going forward. Successful interventions should continue, either through a direct funding model or adoption into government policy.

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