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# Social Impact Bonds and the Financing of Child Welfare

By John Loxley

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# Introduction

Social Impact Bonds (SIBs) are a relatively new way of financing social services in Canada. They differ from the normal way of financing social services in that they are funded initially by private sector businesses or foundations, which are reimbursed by governments after 3 to 7 years only if certain agreed upon performance measures are met. If the targets are met, then the private funders would also be eligible for annual interest payments for the length of the contract, which will usually range from 5% p.a. at the low end for foundations to 30% p.a. at the high end for corporate funders. The attraction for the government lies in not having to front-end the financing and in paying ultimately only on the basis of performance. In the idealized case, the cost savings to the government generated by the service meeting performance goals offset the annual costs of the service, plus the annual interest payment plus any transactions costs involved in the new arrangements, such as legal costs of contracts and civil service planning and oversight costs. This potential to have social programs pay for themselves out of savings, and only having to pay when projects are successful, makes SIBs appealing to governments. The attraction for the private funders is a mix of profit expectation and perhaps a contribution to the corporate social responsibility or charitable goals of the or-

ganization. The attraction for the social service agency is the promise of guaranteed funding for the number of years of the contract (see Loxley, 2013, Loxley and Puzyreva, 2015 and Gustafsson-Wright et al, 2015).

What follows will examine the experience of applying SIBs to the financing of child welfare both in Canada and in Australia and attempt to draw lessons from that experience both for SIBs generally and for funding child welfare in particular. In previous papers our position has been that governments should avoid SIBs and require performance from all social service spending as a matter of course; we have cautioned against introducing private financing into social service delivery expressing skepticism about its possible impact on overall government spending and on unionized workers. In what follows governments have already made the decision to engage in SIBs. This paper examines the form and extent of that engagement and the lessons that might be learned from it. It deals only with SIBs aimed at keeping very young children out of care. There is an older bond, the Essex Social Impact Bond which is aimed at keeping 11 to 17 year olds out of care. This is in its third year and uses multi-systemic therapy. The issues it deals with are generally quite different from the ones considered below (see Essex County Council, 2016).

# The Sweet Dreams Social Impact Bond in Canada

## Objectives and Service Delivery

SIBs were latecomers to Canada, the first one being launched in Saskatoon in May 2014, some four years after SIBs first emerged in the UK.<sup>1</sup> The Sweet Dreams Supported Living Project is a five year SIB funded program aimed at improving the prospects of 22 children (under age 8) of single parent mothers at risk of requiring services from the Child and Family Services Branch of the Ministry of Social Services remaining with their mothers. The Saskatoon Downtown Youth Centre (through EGADZ) provides safe shelter at the Sweet Dreams House as well as programs designed to improve parenting and improve the employment prospects of the mothers. The proposal for a SIB came from the then Social Services Minister June Draude and involved heavy negotiating with EGADZ.<sup>2</sup>

## The Structure of the Arrangement

While the house itself appears to have been financed by the Government of Canada's Homelessness Partnering Strategy (\$207,000), the Provincial Government (\$355,000) and Saskatoon City (\$19,000) (Treaty 4 News), the ongoing programming costing \$1 million is funded equally by the Conexus Credit Union and by Wally and Colleen Mah, two local philanthropists.

It is a fairly simple project with funders dealing directly with the service provider, without the creation of a new intermediary, the Saskatchewan Executive Council performing that function with regard to designing the outcomes measures and the contract (OECD, 2016, p.7). EGADZ is a well-known and respected provider of services to at-risk youth and has a long history and close connections with the private funders.

## The Performance Metric

Should 17 of the 22 children remain with their mothers six months after they have left the program then, at the end of the five years, the donors would receive 75% of their principal and 5% interest per annum. If all 22 children remain with their mothers then 100% of the principal would be repaid together with 5% interest per annum. The maximum return is therefore 5% p.a. and potentially, the whole of the investment is at risk (Gustafsson-Wright et al, 2015, p. 127).

## Transaction Costs

Given the absence of an intermediary, there being only two financing parties and the service deliverer already being selected by the Province, and given a simple and single metric of success,

it was deemed that there was no need to call for competitive proposals and no need for complicated contracts. The whole deal was put together within seven months (Ecotrust Canada, 2014, p. 18). Transactions costs were therefore minimal.

#### Potential Savings to Taxpayers

By helping keep children out of care, the Province expects to save between \$0.54m and \$1.5m over five years depending on its success (Saskatchewan, 2016). These savings do not include other potential savings that might result from improved health, reduced costs for the justice system and social assistance, etc. Total savings, therefore, could be well in excess of those related simply to reducing costs of children in care.

#### Performance to Date

The target metric of 22 children remaining with their mothers six months after their program, was virtually met by June 2016 when 21 had been retained, according to the auditor, Deloitte, appointed for that task (Saskatchewan, 2016, June 21). At its face value, then, this project is well on track to deliver promised outcomes.

#### Investor Returns

If the performance to date is maintained over the five year period then, at the end, the bond holders will receive back 100% of their principal and 5% p.a. compounded on the amount of the bonds.

#### Selection Bias

The problem that has been raised with the performance of this project is that intake selection may be biased by focusing on the motivation of the mothers to keep their children. 'Mothers who lack the drive to keep custody of their children, and thus meet the objectives that trigger investor repayments, aren't admitted to begin with' (Bending, 2016, p. 36). This does not necessarily

mean that Sweet Dreams does not perform a useful social function. What it means is that one does not know how these mothers would have fared without the program. It is also notable that the project has no control group against which to assess its performance. These features expose this SIB to the accusation of cherry-picking winners in order to meet 'profit' objectives (Ryan, 2015), and this may have been a bi-product of a lack of competitive bids or calls for proposals and of a hastily put together performance contract. In other words, this deficiency might be a reflection of the low transactions costs.

#### Unionization, Workers Pay and Benefits

Sweet Dreams is a very small project employing a full-time mentor and one support staff. It draws on its Street Outreach program (which provides services to individuals who are leading or at risk of leading what are called 'high risk lifestyles', EGADZ, 2017) to assist young mothers in the home.<sup>3</sup> Staff are not unionized and to our knowledge, no issues have been raised about pay or benefits.

#### Assessment

There are some distinctive features of this SIB that need to be stressed. It relies heavily on the availability of housing for the mothers involved yet the cost of providing the house is not part of the bond. It also relies on a well-established and respected service deliverer. The underlying social program is targeted and logical. The performance metric is straightforward. The involvement of a credit union as a bond holder is unusual for SIBs but it is a logical one given the social finance mandate to which many credit unions subscribe. The project is small and the returns at best quite low but these might be considered desirable features of what amounts to a trial or pilot SIB project.

The shortcomings of the project are that it is accused of sample selection bias and it has no control group against which performance can be measured.

# Australian Examples

There are two well established Australian examples of SIBs in child welfare, both in New South Wales and both differentiated from most SIBs elsewhere by being financed by genuine bond issues that require them to publish annual reports to their investors. This means, among other things, that these bonds are much more transparent than most SIBs which are not genuine bonds requiring those returns. These are the Newpin Social Benefit Bond and the Benevolent Society Social Benefit Bond. They arose out of a 2010 study for the government by the Centre for Social Impact (CSI), on the feasibility of social benefit bonds in NSW. CSI highlighted two areas of social concern suitable for pilot SIBs: parenting skills for

at-risk families and juvenile justice. Following the issue of a request for proposals in 2011, 11 proposals were received from non-profit organizations to deliver SIBs in these two policy areas. Three were chosen for the joint development phase in which the details of the financial instruments, service delivery arrangements and performance metrics were developed, but only the two child welfare projects were proceeded with at that time (NSW Government, 2017).

The Newpin Social Benefit Bond commenced operation in March 2013 and the Benevolent Society Social Benefit Bond in October that year. These have many similarities but also significant differences worthy of examination.

# The Newpin Social Benefit Bond

## Objectives and Service Delivery

The Newpin Social Benefit Bond is an Au \$7 million, 87 month SIB which was initiated in June 2013. It is designed to improve the family environment for children five years old or less, by providing intensive supports for parents 4 times a week over 18 months. The New Parent Infant Network is a program which aims to break the cyclical effect of destructive and negative family behaviour, prevent child abuse (with a particular focus on emotional abuse and neglect), encourage self-help and lasting change, inspire good parenting, encourage the valuing of positive parent-child relationships, and raise the self-esteem of individual parents' (Urbis, 2014, p. 2). It was originally developed in the UK and is delivered under license in Australia by Uniting Care Burnside (UCB) which has given it a much sharper restoration focus, i.e. on reuniting children safely with their family, and extended it to fathers. UCB

is the largest non-government, not-for-profit provider of community services in Australia. It was established over 100 years ago as a community services ministry of the Uniting Church (Uniting, 2017a). It offers a wide range of social services for the children and youth, the aged, indigenous peoples and the LGBTI community. It is a long established, highly respected social service agency which has won awards for its enlightened employment policies (Uniting 2017b).

UCB offers its therapeutic interventions under the SIB through its Newpin program<sup>4</sup> which has been in operation since 1998 in outer-western Sydney. The bond would enable it to increase the number of its centres from four to ten. Newpin will provide services to over 700 families and over 1,400 children over the life of the bond, drawing them from the following cohorts:

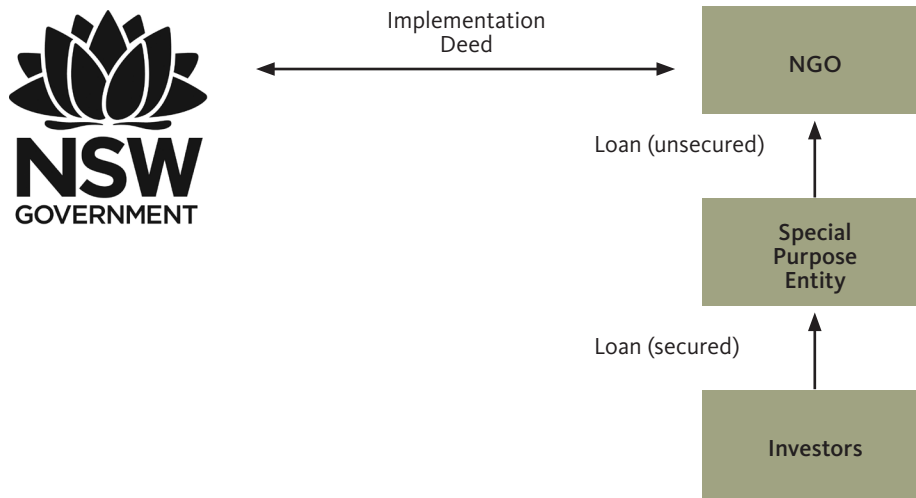
The program offered by the Newpin bond is an enhancement of the long-standing Newpin

**TABLE 1 Newpin Family Cohorts**

<b>Cohort 1</b>	350 Families that have at least one child aged five years or less who has been in out-of-home care for at least three months.
<b>Cohort 2</b>	175 Families that have at least one child aged five years or less that has been assessed as being at risk of serious harm. These children will either be the subject of a Supervision Order or a safety and risk assessment by Family and Community Services (FACS).
<b>Cohort 3</b>	175 Families that have at least one child aged five years or less that do not meet the definitions above but have been identified as needing support to prevent deterioration in the family.

**SOURCE:** Social Ventures Australia (SVA), 2016 p.5 and Gustafsson-Wright et al. 2016, p.119.

FIGURE 1 Newpin Bond



SOURCE: KPMG, 2014, p.14

program offered by UnitingCare Burnside ‘in terms of staffing structure, management/supervision, training and professional development, data collection and reporting’ (Urbis, 2014, p. 5). The Social Benefit Bond (SBB) program also deals with generally higher risk families and puts much more emphasis on restoration of families. ‘It is therefore not appropriate, nor is it feasible, to track and directly compare the performance of the current Newpin program with the previous version of the program’ (Ibid). For that reason, a live matched control group was developed for purposes of comparative performance and evaluation. This group consists of families that meet the Cohort 1 definition but do not receive a Newpin SBB intervention receiving, instead, less intensive FACS programming. The main source of referrals to both the Newpin SBB program and the control group is Community Services Centres (CSCs) although since 2014, family courts play an increasingly important role.

#### The Structure of the Arrangement

The Newpin SBB does not have an Intermediary in the classical SIB sense of bringing all

parties to the table and acting as a go-between for government, service delivery agents and financiers (see Loxley, 2013). The government, through the Department of Family and Community Services (FACS), contracts directly with UCB for the service delivery on the basis of a contractual Implementation Deed. A special purpose entity, the Newpin SBB Trust, handles relationships between the service provider and the investors. Social Ventures Australia (SVA), another well established and highly respected institution, performs some of the functions of an intermediary, essentially on the financial side by managing the trust. SVA was established in 2002 as an independent non-profit organisation. It serves as a funding agent for business, and philanthropists ‘to make their philanthropic dollars go further by giving through a portfolio of innovative social ventures tackling disadvantage’ (SVA, 2017a). It undertakes impact investing and promotes social housing projects and social enterprises. It offers financial advice to further the social aspects of investment. It is a non-religious entity (ibid). SVA designed the Newpin Social benefit Bond, secured investors and acted as the interface between UCB and the



investors. It also sits on a formal working group between government and UCB.

The organizational structure of the bond is very straightforward as diagram 1 shows. The trust secures the loans of the investors and passes them on to Newpin as unsecured loans the principal of which is repaid on maturity out of performance payments received from the NSW government.

There are 60 investors which include UCB, 'high net worth individuals, family foundations and superannuation funds' (Gustafsson-Wright et al. 2016, p.119). The investors were attracted by a combination of commercially competitive returns on investment and social impact (KPMG, 2014, p.30). Bonds were issued in minimum amounts of \$50,000 and there is no secondary market for them as buyers are content to hold them. Take up of the bonds by superannuation funds was considered disappointing and the reasons given were the small size of the issue, uncertainty about risk exposure and lack of information (KPMG, 2014, p. 27, and personal interviews). The guarantees built into the bond arrangements were not aimed specifically at superannuation funds. SVA focused its fund raising on social impact investors and avoided banks.

#### Performance Metrics for Bond Holders

The State of New South Wales Department of FACS, which played a huge role in establishing the bond, is the outcome funder. Payments are geared to the rate at which children are cumulatively restored to their families, as determined by the judiciary system. This 'Restoration Rate' is net of the counterfactual which, in the first three years of the bond is the historic rate of 25% of children completing the program; thereafter, the counterfactual will be determined by a 'matched control group' (Gustafsson-Wright et al. 2016, p.120). Initially, having available the necessary data was a problem and one effect of the SBB has been to help improve the Depart-

ment's own data and record keeping, producing benefits that go beyond the SIB.

Unlike many other SIBs the interest rate is paid annually, rather than at the completion of the SIB life, but adjustments are made based on cumulative outcomes overtime. The interest rate is set at a minimum of 5% p.a. for the first three years. Thereafter, the return is contingent on outcomes and is calculated as follows:

$$\text{Interest Rate} = 3\% + [0.9 \times (\text{Restoration Rate} - 55\%)]$$

with the constraints that the interest rate is zero if the Restoration Rate falls below 55% and with a maximum of 15%.

This scheme institutes a threshold restoration rate of 55%, at which rate an interest rate of 3% p.a. is paid, rising to 7.5% with a restoration rate of 60%, 12% at 65% and a maximum 15% for 70% and above.<sup>5</sup> The principal will be repaid fully on maturity if the restoration rate exceeds 55% if the project runs to year 7. Only 75% of the principal will be repaid if the SBB is terminated in the first 4 years, and only 50% if terminated in years 5 to 7. Thus, given the guaranteed interest rates in the first three years and partially guaranteed principal repayment, threshold guarantees limit bond holder risk.

It is to be noted that the Restoration Rate for pre-SBB Newpin families was 74% in 2012 while the rate for those fostering in programs other than Newpin was only 25%. At the outset, the expectation was that bond holders could receive between a 10 and 13% p.a. return, which compared very favourably with the 5.5–6% return 'expected from a good quality, highly rated Australian corporate bond with a seven-year spread' (Rose, 2013), with maximum total outcome payments over the life of the project of AU \$18.2 million (Social Finance, 2017).

#### Transactions Costs

The transactions costs of the Newpin SBB have been high. It has been estimated that the labour

time devoted to the development of the bond by central agencies, line agencies, service providers and advisors to both government and service providers amounted to 11,712 hours or the equivalent of 6FTEs, at a minimum (KPMG, 2014, p. 29). Assuming an average salary of those involved of \$90,000 p.a.<sup>6</sup> this would amount to over \$0.5m for the Newpin SBB. In addition, SVA estimates legal fees to be around \$100,000 and its own transactions costs at \$150,000. If these are additive, the transactions costs of the Newpin SBB would have been in excess of \$0.75m. These can be considered high on a bond of \$7m but those incurred by the State are likely to fall with subsequent bonds and in any case, they are seen as an investment in developing capabilities as the Department did what it felt it had to do to make the first pilot bond work.

#### Anticipated Value for Taxpayers

The relatively high returns to bond holders and the high transactions costs involved in issuing the bonds are justified on the basis of the costs the government would save if children were kept out of care. Each child in the cheapest form of out-of-home care in NSW costs the state at least<sup>6</sup> \$38,000 p.a. plus associated legal costs. Children often stay in care for years into adulthood and are also often heavy users of other government services. If the Newpin program works as planned the expectation is that the State would save about \$80m in the long run (Rose, 2013), which is significantly higher than the projected total costs.

Over the 7 year period, the NSW government would provide UnitingCare with \$50m which, together with the \$7m SBB loan would be used to fund the annual operating costs of the Newpin program (\$41m), the SBB interest for UnitingCare (\$9m) and the loan principal repayment (\$7m) (SVA, 2013, p. 28).

We turn now to a review of how the SBB has worked in practice for families, children and bond holders.

#### Performance to Date

The numbers of families referred to Newpin has risen from 86 in year 1, to 113 in year 2 and to 125 in year 3 (SVA, 2015, p. 6 and SVA 2016, p. 5). The vast majority of referrals, 79%, have been in cohort 1, families experiencing 'the most challenging circumstances' (SVA, 2016, p.5). In spite of that, the program has now, overall, restored a total of 130 children to their families, 65 of whom have graduated fully from the program, and has also assisted an additional 47 families so that their children were not taken into care (SVA, 2016 p.5). SVA cautions that some of 67 net restorations recorded in Year 3 may later be reversed as they are still within their 12 month assessment period. Thus, 3 of the 42 restorations recorded in Year 2 were reversed in year 3 (Ibid).

In a restorative program such as this, SVA argues that 'some level of reversal is inevitable' (SVA, 2016, p. 5), where a child who was previously in care and returned to family care, was returned to state care. Between 2013 and 2016, a total of 66 families left the program unsuccessfully, i.e. before a restoration occurred, and a further 10 children left after their restoration was reversed. Over the three years the restoration rate has been 60.7% and the rate for mothers and fathers is roughly identical. In 2015 the Newpin SBB Trust agreed, for the purpose of calculating the outcome based payments to investors, to cap reversals at 10% of the cumulative number of restorations, in order to 'protect investors from the uncertain impact of reversals over the balance of the SBB term' (SVA, 2015, p. 9). The impact of this is to reduce the downside risk and raise the restoration rate used in the determination of interest payments to bond holders, calculated for 2016 as follows:

$$\begin{aligned} \text{Restoration Rate} &= (\text{Restorations} - \text{Capped} \\ &\text{Reversals}) / (\text{Restorations} + \text{Unsuccessful Exits}) \\ &= (105 - 10.5) / (105 + 40) \\ &= 65.17\% \end{aligned}$$

(Source: SVA, 2016, p. 9)

## Investor Returns

As noted above, the interest rate used to determine payments to bond holders is linked to the restoration rate. With a Restoration Rate of 65.17%:

$$\text{Interest Rate} = 3\% + [0.9 \times (\text{Gross Restoration Rate} - 55\%)]$$

$$\text{Interest Rate} = 3\% + [0.9 \times (65.17 - 55\%)] = 12.153\% \text{ p.a.} = \text{the financial return to investors.}$$

The annual payment is based on the cumulative restoration rate, such that the total payments to investors are based on the cumulative project outcomes. This results in the actual dollar amount paid to investors in any given year including an adjustment factor to past payments based on the updated restoration rate achieved. This is accomplished by calculating a total payment owed to date back to project start, based on the calculated interest rate (which in turn is based on the updated restoration rate), then subtracting previous payments to investors. For the year 2016, the payment was calculated as follows:

Coupon Payment =

(Amount Invested x Interest Rate for 2016 x Total Elapsed Years) – Prior Year Payments

$$= (\$7,000,000 \times 12.153\% \times 1,187/365) - \$1,404,788$$

$$(\$655,890 \text{ year 1} + \$748,897 \text{ year 2})$$

$$= \$1,361,768$$

Bond holders have, therefore, received over \$2.7m in interest payments in the first three years of the bond. Should the Restoration Rate fall in subsequent years, then the payment to bond holders would fall. sVA add the cautionary note that 'whilst the performance over the first three years has been positive, it is still early in the Newpin SBB and future results may well be volatile. Variations in performance could detrimentally affect the cumulative Restoration Rate and investors' returns' (sVA, 2016, p. 10).

It is worth noting that the effect of capping reversals at 10% is very important to the above

calculations. Thus, if reversals had not been capped, the Interest Rate in year 3 would have been =  $3\% + [0.9 \times (60.7 - 55\%)] = 8.13\% \text{ p.a.}$

And the coupon payment in year 3 would have been =  $(\$7,000,000 \times 8.13\% \times 1,187/365) - \$1,404,787.64$

= \$444,788 or would have fallen by roughly two-thirds!

The renegotiation of terms based on the introduced capping of reversal rates utilized to calculate investor payments therefore led to significant windfall gains to investors.

## Selection Bias and the Control Group

The capping of reversals raises the question of the possibility of bias in the selection of clients and in the calculation of returns to bond holders. A common concern about SIBs is the possible bias in favour of selecting participants with a higher chance of success than others to improve the prospect of paying out the bond; what is known as 'cherry-picking' or 'cream skimming', an accusation made against the Sweet Dreams SIB above. The opposite problem appears to be the case with the Newpin Bond as it appears to be dealing with families and children experiencing above average degrees of difficulty. This is evident from the much higher proportion of Cohort 1 families in the program than initially envisaged, 79% versus 50%. Since the NSW Child Protection Legislation Amendment in 2014 many of these are now referred to Newpin by the family courts whereas in the early days referrals came essentially from staff of Community Service Centres (CSCs) who might have an inherent bias in favour of steering families towards the enhanced levels of service that the Newpin SBB offers regardless of the degree of difficulty families were facing. Now, 'it is possible that many of the families referred to Newpin have particularly complex and entrenched issues that make restoration less likely to succeed' (Urbis, 2015, p. 13).

And having to demonstrate to courts that restoration has been considered as an option ‘may have resulted in some families being referred to and accepted into Newpin for restoration when there may have been some questions about the likelihood of success’ (Ibid). For these reasons, the notion of a cap on reversals in the calculation of returns to bond holders seems eminently reasonable though it is not clear how the precise cap was arrived at.

### Evaluation

The non-financial aspects of the Newpin SBB are evaluated annually on behalf of the state government by the Urbis consulting group. In its 2016 report Urbis concluded that the program had a positive impact on the majority of families; that its net restoration rate for families was almost double that of the control group, and that a lower proportion of children restored to their families were subsequently readmitted to out-of-home care (11%) than those of the control group (13%) (Urbis, 2016, p.53). The programmatic side of the Newpin SBB seems, therefore, to be achieving results.

The Restoration Rate for Aboriginal and/or Torres Strait Islander families participating in the Newpin SBB program is 53% which is more than double that of the control group (25%), but the reversal rate is much lower for the latter, 0, compared with 14% for the Newpin SBB group. The Newpin SBB program is not targeted at Aboriginal and/or Torres Strait Islander families, though a proposed new SBB for Queensland supported by SVA will be. It is to be noted that 20% of the parents in the Newpin SBB program self-identify as Aboriginal and/or Torres Strait Islander families (SVA, 2016, p.54). Since the proportion of such families with children in care in NSW is 35% (Benevolent Society, 2013, p. 4), one could argue that they are under-represented in the Newpin SBB. SVA cautions that one should not read too much into the data on Aboriginal

families as the sample size is small and it is early in the program.

### Innovation

It is claimed that SIBs have the ability to ‘foster innovation in the delivery of social services’ (Gustafsson-Wright et al. 2016, p.42) and to do so either from the outset of delivery by introducing new programs or by adapting as the project is delivered. An examination of 38 SIBs found that none introduced programs that had not been used previously but some were innovative in the sense of programs being applied to different clientele or being delivered by new agents or in new settings (Gustafsson-Wright et al. 2016, p.43).

In an evaluation of the Newpin program it was concluded that ‘the programs that have been selected are not seen to be particularly innovative as they are not ‘new’ programs. The Newpin program is a pre-existing program’ (KPMG, 2014, p.24). The evaluation report went on to say that ‘there is still opportunity for innovation to occur within the model at the service delivery level as the Trial rolls out’ (Ibid). Newpin would argue that adapting their program to fathers as well as mothers, giving a greater focus on restoration and operating at multiple sites and new approaches to staff training are all innovations (see, Urbis, 2014, p. 11) but the core of their program has been well established for years.

The evaluation found that service innovation might have been in contradiction to ‘developing a bond with a sound evidence base’ and it is in the area of social financing that the Newpin SBB is truly innovative. The evaluation concluded that ‘there was agreement that the Trial was an exercise in financial innovation of a new product and form of contracting that has not been previously used in NSW’ (KPMG, 2014, pp25–26). Development and successful floating of the SBB might not have been possible with completely new and untested forms of service delivery.

### Additionality of Funding

A frequent claim in favour of SIBs is that they bring additional funding to social service agencies. The difficulty in establishing this is that philanthropic foundations usually face excess demands for their funds so investing in SIBs might well constitute just the diversion of their funds rather than an addition. Hence the conclusion reached by the Brookings study of SIBs, that while SIBs crowd in private funding ‘this does not by definition mean that this constitutes additional capital (though it is possible that it could)’ (Gustafsson-Wright et al. 2016, p 38).

Likewise, government putting additional funds in SIBs would almost certainly be at the expense of government services elsewhere. Governments may benefit from the initial funding of services by SIBs but, ultimately, may end up paying for their costs together with a bonus premium. In that case, true additionality would require government to save more in reduced service costs than the operating costs, the premium and the transaction costs of the SIB. The question would also arise as to what the private funder does with the bonus payment. It is more likely that charitable foundations and social finance agencies will reinvest in social programs than private financial institutions, but that remains to be seen. In the case of Newpin, it is too early to say what the overall impact on government spending will be or on what funders are likely to do with any surplus on the bond after 7 years, and the discussion of additionality revolves around whether private funds for the SBB represent truly additional private funding of service delivery. While we have no definitive evidence on this, a survey of funders of the SBB conducted by SVA shows that ‘funds invested in the Social Benefit Bonds are ‘new’ and not a diversion of funds that would have otherwise gone into philanthropic donations’ (KPMG, 2014, p.27). In interviews with state officials it was also said categorically that funding raised through the SBB was ‘unambiguously additional’.

### Impact on Unionization, Workers Pay and Benefits

The possible negative impact of SIBs on worker pay and benefits has been raised as a concern in Canada (Loxley, 2013) and elsewhere (Whitfield, 2015). This is less of a concern in Australia as the terms of service of all workers are covered by Enterprise Agreements or awards whether workers are unionized or not. ‘Uniting Newpin staff (including those working under the bond) are covered by an Enterprise Agreement, and the relevant unions are parties to the agreement, where there is member coverage. Union membership is optional, and the Agreement applies regardless of whether an employee belongs to a union or not.’<sup>8</sup> The Agreement has been in place since 2005. In their critique of social impact bonds, based on the Newpin model, the Australian Service Union (ASU) does not raise unionization as an issue (ASU, 2016).

### Assessment

The Newpin SBB is different from many other bonds in that it really is a bond with a detailed information memorandum for investors and the requirement to publish an annual report covering payments to bond holders which also means publishing records of restoration and service delivery on which those payments are made. This gives the Newpin SBB a degree of transparency which is unusual for SIBs.

Both the service deliverer and the (financial) Intermediary are well established and highly regarded institutions with strong track records bringing what one interviewee called a ‘survivor bias’ into the institutional selection. This factor would need to be considered in any future efforts to replicate this program.

The Newpin program has had some success to date but because of the cumulative nature of the metrics and the apparent bias in family selection towards cohort 1 families, care must be taken in assessing these results and their likeli-

hood of continuing. The metric calculations have been adjusted to limit the possible negative impact of this sample bias. The State of NSW has also built guarantees into both interest payments and principal repayments.

The innovation in this SIB is largely confined to financial innovation in the development of the SBB and it is claimed that the private funding going into child welfare through Newpin is additional funding.

Risks to lenders on both Principal and interest payments are limited. The main risks to both Uniting Care and the FACS are essentially reputational in the event that the bond fails to deliver improved service performance.

In a critique of SIBs, based on the Newpin model, the ASU has argued they may lead to a bias in service delivery, targeting 'easier' client

groups, 'leaving those with complex issues and needs between the gaps of the service system' (ASU, 2016, p.23). It is concerned that SIBs may fundamentally change the nature of the not-for-profit (NFP) sector, putting the profit motive and outcomes above process and care for people. It worries that private funding of services may be subject to market downturns and 'does not address circumstances where a service is of great social importance, but is not 'popular' or 'attractive' for companies to invest in'. It holds that

services for the most vulnerable are 'best provided by the NFP sector, with effective prevention programmes the only way to achieve the right health and social outcomes, including cost savings in the long term' The ASU concludes that SIBs 'should not be recommended as an innovative model' (ibid).

# The Benevolent Society Social Benefit Bond

## Objectives and Service Delivery

The Benevolent Society Social Benefit Bond is a 5 year, \$10 million joint venture between The Benevolent Society and two banks, the Westpac Institutional Bank and the Commonwealth Bank. The objective of the bond is to keep at risk children under the age of 6 out of care by providing up to 400 families with a program aimed at helping them address issues such as unstable housing, debt problems, regular income, domestic violence, substance misuse and family functioning and relationships (New South Wales Government, 2017). The Benevolent Society will deliver the Resilient Families program, based on the US Homebuilders Program, for up to nine months for each family with the first six weeks consisting of assessment and intensive home visiting. The program also aims to keep families safe in the longer term. Eligible children must be living at home and deemed by FACS to be at risk of significant harm but 'Safe with Plan' (ARDT Consultants, 2014, p.3). Selection of families and the matching control group against which their performance is measured is centralized through FACS which confirms eligibility through a series of selection criteria and after checking the currency of information with the relevant CSC. Selected families are then referred directly to the Benevolent Society as

vacancies arise in the program (ARDT Consultants, 2014, p.9).

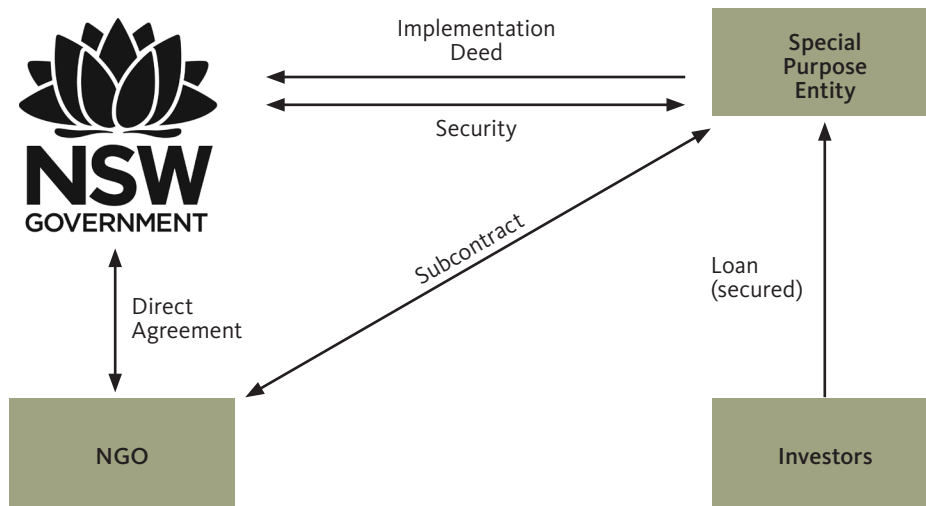
The Benevolent Society was formed in 1813 as the NSW Society for Promoting Christian Knowledge and Benevolence. It was Australia's first charity and operates as a non-profit organization. It was renamed The Benevolent Society of NSW in 1818, becoming a non-religious organisation, which it remains today (Benevolent Society, 2017). It works with other organizations 'to improve the wellbeing of children, young people, families and older Australians, especially in disadvantaged communities' (Ibid). The Resilient Families program was a new program for the Benevolent Society when it commenced as part of the bond in 2013.

## The Structure of the Arrangement

The structure of the Benevolent Society Bond is more complex than that of Newpin because of the greater complexity of the financing arrangements.

Again, there is no intermediary in the traditional sense, the government playing some aspects of that role in, for instance, the selection of the service deliverer. The special purpose entity is the Trust, the sole member of which is the Benevolent Society.

FIGURE 2 The Benevolent Society Bond



SOURCE: KPMG, 2014, p.14

Unlike the Newpin Bond, The Benevolent Society SBB has two classes of bond: Class P of Au \$7.5 million for Senior Investors and Class E of Au \$2.5 million for Subordinate Investors, each with a minimum holding of \$50,000. Class P bonds carry a zero risk to the principal and an interest rate of between 0 and 10% depending on the level of performance, while Class E bonds carry a 100% risk of loss of the principal but an interest rate of between 0% and 30% depending on performance. Payments of principal and interest returns to Class E holders will occur only after Class P or senior lenders, have been paid. The maximum payment to investors under the SBB is AU \$ 18.2 Million (Social Finance, 2017).

Banks, financial institutions and high net worth trusts figure more prominently among those holding these bonds than they do among those holding the Newpin bond, although high net worth individuals invested too. Senior Investors include the Benevolent Society, Westpac Foundation and the Commonwealth Bank of Australia. The banks involved raised funds from their investors, ‘including high net worth individuals, self-managed super funds, trusts, small foundations and institutions’ (Gustafsson-

Wright et al. 2016, p.121). Subordinate Investors include the Benevolent Society, Westpac and the Commonwealth Bank of Australia. There are 44 investors in total (Ibid).

The Benevolent Society SBBs can be sold on to others who must be resident Australians, as one apparently has been, but they cannot be listed on stock or security exchanges and neither the issuer nor the bonds can be rated by bond rating agencies (Benevolent Society, 2013, p. 15).

In addition to the bond proceeds of A\$10m, payable to the Benevolent Society in monthly instalments of Au\$166,667 for 5 years, the Government of NSW provided an upfront standing charge (an upfront payment) of Au \$5.75 million ‘to facilitate the establishment of the program for the Resilient Families Services’ (Benevolent Society, 2013, p.17), in effect making Class P shares more appealing to would-be bond holders.

The Benevolent Society SBB is governed by no fewer than 16 ‘main’ documents and legal agreements, covering all aspects of the financial and service arrangements (Benevolent Society, 2013, pp.18–19). These are often very complicated, in part because of the two bond offerings and in part because they built on the prior experience



**TABLE 2 The Interest Rate on Class P and Class E Bonds**

Performance Level	%	Interest Rate % p.a.	
		Class P	Class E
Fail	(<5%)	0	0
Baseline	(≥5% <15%)	5	8
Good 1	(≥15% <20%)	6	10.5
Good 2	(≥20% <25%)	7	15
Good 3	(≥25% <35%)	8	20
Good 4	(≥35% <40%)	9	25
Out-Performance	(≥40%)	10	30

**SOURCE:** Benevolent Society, 2013, p. 24 and p. 34

of the Newpin bond, which appears to have only 6 such agreements (Social Ventures Australia (SVA), 2013, pp. 25–27). As a result, the deal took many months to complete.

#### Performance Metrics for Bond Holders

Returns to bond holders are paid at the end of the 5 year contract and are based on a weighted average of three indicators applied to the Index Child, which is the youngest child in the family at the time of the referral. The indicators are the number of entries into out-of-home care, which has a weight of 66%, the number of Child Protection Helpline calls for suspected risk of significant harm to children (17%), and the number of safety and risk assessments (17%). Each is measured for the intervention group minus the measure for the control group. The “Improvement Percentage” for an Annual Cohort will be calculated as follows:

$$\text{Improvement Percentage} = (66\% \times \text{Entries}) + (17\% \times \text{Reports}) + (17\% \times \text{Assessments})$$

and will be verified by an Independent Certifier.

Interest payments on the two types of bond will vary according to the degree of improvement of children in the Resilient Families program versus those in the control group, the Improvement Percentage, adjusted to a Performance Percentage ‘to mitigate the impact to Holders in the

event that an Index Child cannot be matched (an “Unmatched Child”) or where the Department does not provide the guaranteed level of referrals’ (Benevolent Society, 2013, p.6).

Thus, if there is a less than 5% improvement in the intervention group versus the control group, then performance is deemed to have failed and zero interest will be paid at the end of the 5 years to either Class P or Class E bondholders. Thereafter, as relative performance improves, the interest rate on Class P bonds rises from 5% p.a. compounded to a maximum of 10% p.a., while that on Class E bonds rises from 8% p.a. to a maximum of 30% p.a.

In 2016 the Improvement Percentage was 17% and the Performance Percentage was 19% (Benevolent Society, 2016, p. 13).

#### Transactions Costs

The transactions costs of the Benevolent Society SBB are not known but must have been somewhat higher than those of the Newpin bond. The labour time devoted to the development of the bond by central agencies, line agencies, service providers and advisors to both government and service providers amounted to the same as that involved in the Newpin bond, 11,712 hours at a minimum or their equivalent of 6FTEs (KPMG, 2014, p. 29) at a cost of likely over \$0.5m. The greater complexity of this bond, its numerous agreements and the

**TABLE 3 Improvement Percentage, Cohorts 1, 2/3**

Measure	Result	Result	Weighting	Improvement Percentage	
	Cohort 1	Cohort 2/3		Cohort 1	Cohort 2/3
Out-of-Home Care Entries	21%	21%	66%	13.86	13.86
Safety and Risk Assessments	(75%)	61%	17%	-12.75	10.37
Helpline Reports	13%	29%	17%	2.21	4.93
				3.32	29.16

**SOURCE:** The Benevolent Society, 2016, p. 12

additional time taken to negotiate them would most surely have led to much higher transaction costs, but these are not available.

#### Potential Savings to Taxpayers

Unlike the Newpin bond, no estimates have been published on the likely savings to the NSW government if the Benevolent Society SBB is successful. If, however, the average annual cost of a child in care is indeed A\$38,000 (which has been questioned as being very low, see endnote 3), and interest payments over the period average the rates for 2016 (next section), then at the end of the bond a total of some A\$14.2m would be paid to bond holders. For the Government of NSW to ‘recover’ this would mean keeping a total of 374 children out of care for one year, or an average of 75 for each annual cohort. Since the average annual cohort consists of only 80, this would mean a success rate of 94%, compared with much lower historical records. Adding transactions costs would mean an even greater proportion of children would have to be kept out of care. On the other hand, the success rate required drops dramatically if children are kept out of care for more than one year, if savings other than foster care are counted and if the average cost of foster care is as high as claimed in endnote 3.

#### Performance to Date

The program has been successful in reducing the number of children taken into out-of-home care

by 21% above the control group for both cohort 1 and cohort 2 plus the first months of cohort 3. It has also reduced reports to the FACS Child Protection Helpline (helpline reports) for children in the program by 13% and 29% respectively for cohort 1 and cohorts 2/3 relative to children in the control group. What stands out in Table 2 is that for cohort 1 the Intervention Group performed much more poorly on Safety and Risk Assessments (SARAS) than the control group, though the reverse was true in cohorts 2/3. The Improvement Percentage improved markedly, therefore, over the past two years.

#### Investor Returns

The Performance Percentage for the 33 months ended 30 June 2016 is calculated to be 19%, which means that if this continues cumulatively over the five year period then Class P bond holders would earn 6% p.a. compounded and Class E would earn 10.5% p.a. (see Table 1). Since interest is paid only at the end of the five years, at this stage these returns are considered ‘theoretical’ (The Benevolent Society, 2016, p. 13).

#### Selection Bias and the Control Group

The method of calculating the Improvement Percentage was changed in 2016 because in earlier years both the SARAS and the number of helpline reports had risen well above those in the control group. This was found to be due to observation bias in that children in the Intervention Group

were subject to intense monitoring by case workers, who have a mandated responsibility to report on these issues, while children in the control group were not. This observation bias was confirmed in two reports by outside consultants and was held to lead to measurement bias (The Benevolent Society, 2016, p. 10). As a result the measurement was changed to include only Helpline Reports from NSW Police and health care professionals, excluding those from case workers. Only SARAS which commenced after the children had been in the program for six months would be included in the Improvement Percentage measurement, to allow 'time for the impact of the case plan, support and work undertaken with the family to start to have an impact on the level of family functioning' (Ibid).

This development speaks to the difficulty of drawing up meaningful measures of performance so critical to the very essence of SIBs. It also raises questions of the ethics underlying the differential degrees of servicing and monitoring of the two groups of children, the problems of control group children (who continue to receive 'business as usual' services from FAC) being played down purely because of inadequate monitoring. On the surface it looks as if the measurement system was changed to improve outcomes and returns to bond holders. On the other hand, it needs to be recognized that the use of an Index child in these measurements possibly understates the benefits of the program by ignoring that other children in a family are likely to benefit from the Resilient Families program. Furthermore, the three measures used in the Improvement Percentage are quite narrow and the Benevolent Society argues that it achieves much more than them in the form of additional outcomes. These are increased safety of children and families, stable and secure relationships, improving coping/self regulation, increased self efficacy and improving empathy. It publishes indices of families' personal wellbeing at entry and exit that show improvement in several proxies

for these additional outcomes (The Benevolent Society, 2016, p. 15). ), but these have no impact on returns to bond holders.

Formation of the Intervention Group has also raised issues of sample selection bias. Three key definitions were used to determine selection of families: the number of previous reports to the Helpline for Index Children, the absence of predictive risk factors for contact with the child protection system, and the outcome of the Risk Assessment in the SARA undertaken at the time of referral to the RF service. ARDT Consultants (2016, p. 11) found that at least twenty per cent of families have lower than expected risk on all three definitions and this applied to both the Intervention and the Control Groups. On the risk of contact with the child protection system, they found that 31% of Index Group Families and 41% of Control Group Families have 0 or 1 of the 5 predictive risk factors, viz. parental substance abuse, family conflict or violence, mental health problems, a history of child abuse and neglect, and large family size (more than 3 children) (ARDT, 2016, p.12). They concluded that the 'analysis indicates that there are likely to be lower risk families for whom the high intensity of service that the RF service offers may be unsuitable' (ARDT, 2016, p.11).

The implications of this sample selection bias are potentially complex. On the one hand the absolute performance of Index Group Families is likely to be better than it would have been if more challenged families had been selected, as was the original intent of the program. On the other, the fact that the Control Group had a higher percentage of families with low predictive risk factors would bias the calculation of Performance Improvement against Index families and might, therefore, reduce returns to bond holders, as 'there is less scope for the service to reduce contact with the child protection system among families with lower risk profiles, especially in relation to OOHc (out of home care) entries' (Ibid, p. 12).

Relatively few Aboriginal and Torres Strait Islander families and children are involved in the Resilient Families program, perhaps because as some FACS and Benevolent Society staff believe ‘the referral process may be leading to systematic exclusion of families with high risk profiles whereby their unique circumstances made them difficult to match’ (ARTD Consultants, 2015, p.12). This reinforces the sample selection bias of low risk families being chosen.

### Evaluation

The Benevolent Society SBB is evaluated annually by ARDT Consultants. Apart from the sample selection bias, they have identified delays in admitting families to the program as a major structural problem. The Homebuilder’s Program on which the Resilient Families (RF) model of intensive services is based, is premised on the theory that ‘clients will be most receptive to change at a time of crisis, so it is important to engage them at this point in time’ (ARDT, 2016, p. 12). The RF intervention commences on average 5.2 weeks after FACS commence the SARA, and in the extreme could take as long as 23 weeks, ‘meaning the critical engagement period may have passed by the time families are introduced to the RF service’ (ARDT, 2016, p.vi). Service delivery workers hold that the delay is ‘unhelpful in their efforts to engage families’ (Ibid, p.10).

The ARDT evaluation found a number of positive outcomes for the RF program. Primary Carers report less distress and improved well-being, and Index Children face fewer social and emotional difficulties while their families show greater resilience over time. The improvement is greatest for highest risk families. RF families had less contact with the child protection system over time on the basis of the three components in the Improvement Performance measure; reports made to the Helpline, SARAS commenced and entries into statutory out-of-home care. Similar results were, however, found for Control Group

families ‘making it difficult to draw conclusions around the overall effectiveness of the RF service’ (ARDT, 2016, p. 36). Control Group children had a reduced number of Helpline reports and fewer SARAS but more of them were taken into out-of-home care (18) than Index group children (15). Control Group families continued to receive services from FACS but not of an intensive type. The consultants were unable to say exactly what form these services took but postulated that simply being assessed for membership of the Control Group might have spurred families to reduce future contact with the child welfare system (ARDT, 2016, p. 37).

### Innovation

The Resilient Families model is, as we have seen, a pre-existing program in the United States which has been adapted to NSW conditions. The degree of innovation is, therefore, likely to be only slight on the service delivery side (KPMG, 2014, p. 25). One innovation for expecting mothers has been the use of Baby Ray, a computerized baby doll which sends data to the intervention team on how the ‘baby’ has been treated, fed and clothed. This helps educate expectant mothers on how to take care of babies and keep them safe (The Benevolent Society, 2015, p. 10).

Like the Newpin Bond, the extent to which performance is measured and evaluated annually can also be considered very innovative as it does not apply to other programs funded by FACS. Neither do other programs have control groups against which performance is measured.

Also like the Newpin Bond, analysts have concluded that innovation was most pronounced on the financial side (KPMG, 2014, p.26). The introduction of the upfront standing charge was an important further innovation designed to support the guarantee of the principal given to Class P bond holders and was held to be key in the successful launch of the bond (Ibid, p. 18). This is not, however, meant to be a precedent as

the expectation is that as the bond market matures such incentives will become unnecessary.

#### Additionality of Funding

Like the Newpin funding, monies raised under the SBB are considered additional. In this case the predominance of commercial lenders who would not normally fund social service delivery is cited as the main justification for the claim that funds 'are 'new' and not a diversion of funds that would have otherwise gone into philanthropic donations' (KPMG, 2014, p. 27).

#### Impact on Unionization, Workers Pay and Benefits

Since the end of 2016, The Benevolent Society has an enterprise agreement with its employees and the ASU were a part of the consultation and negotiation process. Before that, terms and conditions of service of staff were covered by a federal award, specifically the Social, Community, Home Care and Disability Services Industry Award 2010.<sup>9</sup> Unionization does not appear to have been an issue in this SIB.

#### Assessment

The Benevolent Society SBB is the most complicated of the three studied here. Offering two types of bond with different degrees of risk, and to large financial investors, introduced a degree of legal and organizational complexity not found

in the others. The service deliverer is a long established and highly respected organization drawing on a program that has a track record in the US.<sup>10</sup> The program in NSW aims at reducing the likelihood of children who have never been in care from being taken into care. Results to date are promising with marked improvement in the well-being and safety of children and families, but similar improvement was found among children in the Control Group. If progress to date continues, bondholders can expect to receive between 6 and 10.5% p.a. at the end of the five year period, returns well in excess of those on the regular bond market. Observation and measurement bias have been issues leading to revision of the performance metric on the basis of which bondholders are paid. It is also alleged that there is sample selection bias leading to low risk families gaining unintended access to the program and some high risk groups being excluded. Innovation in this bond is, as with the Newpin Bond, largely confined to financial innovation in the development of the SBB, but it does focus more on measurement of outcomes and against a control group, than other programs offered by the Benevolent Society. Also, again as with the Newpin Bond, it is claimed that the private funding going into child welfare through this bond is additional funding (KPMG, 2014, p.27).

Risks to lenders are limited in the case of Class P bonds. The main risks to both the Benevolent Society and the FACS are essentially reputational in the event that the bonds fail to deliver improved service performance.

# What Lesson Can Be Learned From These Three Social Impact Bonds?

The following lessons seem to flow from examination of the three SIBs in child welfare:

1. SIBs of differing programmatic content and different degrees of complexity have been applied to the problem of rising numbers of children in care.
2. Service deliverers in each of the three cases studied had successful track records and strong reputations for quality delivery.
3. The program of each SIB seems to show some signs of success but each has also been subject to claims of sample bias, observation bias or measurement bias which makes it difficult to measure absolute and relative performance with any degree of accuracy.
4. In two of the three cases the bias observed may not necessarily have improved returns to bond holders.
5. Only two of the three SIBs used a control group to measure relative performance.
6. Programmatic innovation in each of these SIBs seems to have been slight. The availability of safe housing was key in the case of Sweet Dreams but this was not funded by the SIB.
7. Innovation in all three was essentially financial.
8. A greater emphasis on outcome measurement and the use of control groups (in two of the three cases) can also be considered innovative.
9. Marketing SIBs allows for greater transparency as annual reports for investors are required to be published.
10. In none of these cases was an 'orthodox' intermediary used. Government played a central intermediary role in all three, directly contracting for service delivery.
11. Transaction costs were low in the case of the simplest SIB and, as is to be expected, rose with the complexity of the arrangements.
12. Government guarantees were central to the successful launch of the marketed bonds. These took the form of guaranteeing principal or interest payments, capping reversals of family restorations, adjusting performance measures for 'observation' bias and/or making an upfront standing charge.
13. These guarantees and the relatively large transaction costs in the Australian SIBs can be explained by the 'trial' nature of the bonds, perhaps a necessary part of building

an enabling environment for SIBs, as was the creation of the Office of Social Impact Investment in the NSW government which offers a variety of services to encourage the adoption of SIBs.

14. Planning the larger SIBs takes time and the performance metrics can be expected to be adjusted with experience, especially if returns to investors seem threatened.

15. Whether or not SIBs produce additional financing for social programs depends very much on individual circumstances and options available to investors.

16. Unionization, pay and benefits do not appear to have been an issue. The Australian SIBs have a union presence and are covered by Enterprise Agreements. Sweet Dreams employs only two staff directly.

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# Endnotes

- 1** Canada was the 7th of 18 countries who have implemented SIBs as of Feb 2017, so was middle of the pack in that sense.
- 2** Email communication with Don Meikle, Executive Director, Saskatoon Downtown Youth Centre Inc – EGADZ, June 12, 2017.
- 3** *ibid*
- 4** It is actually the Unitingcare Children, Young People and Families division of Uniting which offers the Newpin services (SVA, 2016, p.5)
- 5** In fact the rate of 15% would be paid at a Restoration Rate of 68.3% if the formula is adhered to.
- 6** Average salaries in NSW are published in [https://au.indeed.com/cmp/Nsw-Government/salaries?job\\_category=admin](https://au.indeed.com/cmp/Nsw-Government/salaries?job_category=admin). The \$90,000 figure would seem to be representative of middle level staff salaries.
- 7** This cost number is for 2012-13, but an earlier 2009 study by the Boston Consulting Group put family based foster care costs at up to \$A66,000 and residential care at A\$303,000 per child per annum. See Benevolent Society, 2013, p.4.
- 7** Email communication from Elyse Sainty of Social Ventures Australia, May 11, 2017).
- 9** Email communication with Claudia Lennon, The Benevolent Society, 5 May, 2017.
- 10** That track record is, however, open to dispute. ASPE, 2002, concluded that 'No significant differences were found between the experimental and control groups on family level rates of placement, case closings, or subsequent maltreatment'. It also stated that 'A number of previous evaluations with relatively rigorous designs have failed to produce evidence that family preservation programs with varying approaches to service have placement prevention effects or have more than minimal benefits in improved family or child functioning.'





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