What steps can the Commonwealth Government take to help access more private capital for social impact investing to address some of Australia’s greatest social challenges?

With the budget announcement of $30 million to support Australian impact investing, the Commonwealth Government has signaled its intent to take a greater role in fostering a vibrant and thriving impact investing market.

In this article, we recommend the steps that the Government can take to unlock greater pools of private capital to address some of our most challenging social issues – from low-cost housing, to employment opportunities for marginalised job seekers.

The article is based on SVA’s response to the Government’s Social Impact Investing Discussion Paper earlier this year, which sought views from the sector on what role the Commonwealth could play in expanding the social impact investing market. (See SVA’s Response to the Commonwealth Government’s Social Impact Investing Discussion Paper.)

Why social impact investing at all?

Social impact investing (SII) is the investment of private capital to achieve both a financial return and a social return, usually in the form of improved social outcomes for vulnerable individuals and communities. SII is defined more by the intent of the investment and its measurability than the type of product itself; that is, SII covers debt finance to non-profit housing providers, equity investment in social enterprises and social impact bonds (SIBs) to fund service providers to
address a targeted high cost social issue.

SII can provide a new source of funds to help scale programs, as is the case with SIBs, or it can act as a more tailored and flexible source of funds to invest in projects or organisations that otherwise might not have access to traditional capital markets. Other benefits of SII include:

1. Building stronger partnerships between government, community and private sectors to solve social problems;
2. Helping improve accountability and transparency of performance through monitoring of progress against agreed social outcomes;
3. Sharing financial and performance risk with investors and service providers – allowing better risk management for governments;
4. Encouraging governments to better utilise their data to gain insight into the cost of disadvantage and the impact of existing and new interventions; and
5. Assisting governments and service providers to better understand and quantify the cross-portfolio costs and benefits of the delivery of social services, including early intervention and prevention programs.

While SII has grown substantially in the UK and US in the last decade, Australia has been relatively nascent with significant untapped potential.

With a growing number of investments – including state government SIBs – and more organisations taking part either as a service provider or funder, we’re now on the cusp of something much larger and perhaps, more mainstream.

With the right supporting infrastructure and initiatives in place, Australia’s burgeoning SII market could mature much more quickly, bringing with it an evolution in the kinds of investors, the nature and scale of the transactions and the impact that SII can have on the lives of disadvantaged people and communities.

How impact investing works

To understand where it is best for the Commonwealth to intervene, it’s important to understand how impact investments work. They have several core elements (see Figure 1).

Impact investments need a source of revenue which will ultimately provide returns to investors. An enterprise or service delivery organisation generates returns in the form of outcome payments that the organisation has received (from government); rent or capital gains on property; or operating revenue from sales.
Social impact investments can take different investment forms – debt, mezzanine (or hybrid) finance, and in some cases, equity in the organisation.

And, there needs to be an identified investment entity – whether an entity that pools investors’ funds, an institution like a super fund, or an individual or family foundation.

For example, a superannuation fund may provide debt into a large social/affordable housing project to make a financial return through rental income and sales of market based dwellings of the project.

Given the unique nature of the investment opportunities and capital providers in the SII market, in many cases it’s necessary for an intermediary to link the capital with the investment opportunities in the right structure. Currently there are few intermediaries in Australia with experience in constructing and executing these transactions.

2017/18 Commonwealth budget

The Commonwealth Government has taken some encouraging steps toward supporting impact investing in the 2017/18 budget with a $30.4 million package to support the development of the market as well as $63 million over four years for the establishment of a National Housing Finance and Investment Corporation.

The Corporation will operate an affordable housing bond aggregator (see article, New model for financing affordable housing) to provide long-term, low cost finance for social and affordable housing. The aggregator will overcome some of the barriers to greater private sector investment and will attract institutional investment to fund much needed affordable housing stock.

From 2017/18, the Government will invest $10.2 million over 10 years to trial the use of social impact investments aimed at improving housing and welfare outcomes for young people at risk of homelessness. The trials will be undertaken in partnership with States and Territories and target priority groups, including those supported by specialist homelessness services exiting the out-of-home care system or institutions such as juvenile detention.

This complements broader SII funding where the Government is providing $20.2 million over 10 years to encourage the continued development of the SII market in areas other than homelessness.

This additional funding includes $8 million over four years to establish a SII Readiness Fund that will help organisations to build their skills and capabilities to develop projects and business plans for SII opportunities. It also includes $12.2 million for additional investment trials and to facilitate data sharing and improved outcomes measurement — with the States and Territories.

What are the next steps for the Federal Government?

There are many ways in which the Government can support and participate directly in the social impact investment market, including by underpinning specific investments with a desirable social outcome (e.g. SIBs, rent subsidies for new housing stock), and by providing vital SII infrastructure to grow the market over time (including data, community sector capability building, and social procurement).

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of mutually beneficial measures…

The Government can also support regulatory changes to ensure that different kinds of investors have more opportunities to participate in Impact Investing such as making it easier for private philanthropists to make capital available for impact investments. This would in turn increase the potential pool of funding for SII mechanisms with different risk and return profiles.

The experience both from the early steps made by state governments such as SIBs and from other countries is that it is essential to have a coherent set of mutually beneficial measures that create a virtuous cycle within the SII market, rather than just one off initiatives, the impact of which ends with the investment.

Specifically, SVA recommended the Commonwealth Government play an active role in expanding the Australian SII market in the following ways:

**A Minister and Office for Social Impact Investing**

Appointing a Federal Minister with responsibility for social impact investing, within the treasury and finance portfolio, would ensure appropriate exposure for the SII policy which is essential in order to generate cross-department support. Experience both in Australia and overseas suggests that a central point enables coordination of SII across government.

In NSW for example, the NSW Government has established an Office for Social Impact Investment which has provided the catalyst to accelerate the growth of the social impact investment market across the state. This has included the delivery of a social impact investment policy and a commitment to bring two social impact investments to market each year for four years.

**Support the pipeline of investment ready social enterprises**

One of the other barriers to the development of the impact investing market in Australia to date has been the relative scarcity of large-scale, investment-ready opportunities.

**The Commonwealth has a role to play in supporting social enterprises to become ‘investment ready’ so that their impact can be scaled.**

Australia’s Social Enterprise Development Investment Funds, which offer finance and support to help grow eligible social enterprises, have collectively committed just over half of their available funds. Similarly, in the UK, scale has been problematic in the market’s early years. Big Society Capital, a UK-based independent social investment institution, and its co-investors have so far drawn down only £195 million of the £587 million available to invest.

Appetite for SII in Australia has been growing but currently there is not a strong pipeline of high
impact ‘investment ready’ social enterprises. The Commonwealth has a role to play in supporting social enterprises to become ‘investment ready’ so that their impact can be scaled.

In the UK, the Government’s Investment and Contract Readiness Fund (ICRF) supports social ventures to build their capacity to be able to receive investment and bid for public service contracts.

The ICRF has helped social sector organisations acquire the strategic, finance and legal skills they needed to raise investment and compete for contracts. A 2015 review of the ICRF program found that for every £1 spent by government on this Fund, it unlocked £23 of contract value.

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

The Commonwealth budget announcement of $8 million over four years to establish a Social Impact Investment Readiness Fund to build capacity in the non-government and private sector is a good start. It will assist in the development of more social impact investment proposals and should complement existing capacity building initiatives supported by Impact Investing Australia and NAB.

However, more support is needed to deliver the necessary pipeline of social enterprises.

Social procurement and generating demand

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

Combining increased use of social procurement with leveraged investment and contract readiness funding is a highly efficient way to stimulate growth in social enterprise...

This can lead to demand for the products and services supplied by social enterprises and create large working capital needs, and hence impact investing opportunities, for winning bidders. Yet
the social procurement opportunity is much broader – both in terms of the range of potential procurers (all levels of government and the corporate world) and suppliers which could be used to stimulate social enterprises targeting issues, such as long-term unemployed or youth at risk.

Many Australian states are in the process of developing social procurement strategies and targets that include not just Indigenous business but also social enterprises, including Victoria, NSW and Queensland. Likewise in addition to the Indigenous procurement policy, the Federal Government could further develop social procurement by using its purchasing power in this way.

Social procurement in the UK has fuelled the growth of social enterprise champions…

In the UK, the Social Value Act is a relatively new law that requires that commissioners of public services consider social impact factors in tendering processes and not just focus on price. Social procurement in the UK has fuelled the growth of social enterprise champions such as the HCT Group, a social enterprise that operates many of London’s red buses, providing 20 million passenger trips every year.

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

Driving the SIB market to generate Government learnings and greater investor experience

The Commonwealth Government has a role to play fostering a national social impact bond capability, creating an environment where governments pay service providers to achieve a set of social ‘outcomes’, rather than just on traditional ‘outputs’.

The Government could play any or all of the following roles in the Australian SIB market (Figure 2):

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

Outcomes-based commissioning and access to data to underpin new transactions

As a large procurer of services from the social sector, the Commonwealth could encourage further outcomes-based commissioning (other than SIBs), which delivers benefits for clients of
For SII to be successful over time, access to good outcomes data, good unit cost data and savings data is essential.

Traditionally, governments have funded services by paying for tightly defined inputs, activities and acquittals. This has created barriers to innovation which could provide improved outcomes for people receiving the services. SII will be both a beneficiary of and a catalyst for outcomes contracting as it will encourage Government to pay for successful outcomes.[5]

To be successful, outcomes-based commissioning must include a process for working with the group of people who will receive the service to identify their needs and desired outcomes; careful assessment of the data points on which success is measured and contracting structures which avoid perverse incentives and appropriately share risk. For SII to be successful over time, access to good outcomes data, good unit cost data and savings data is essential. Data is critical to outcomes-based payments and over time both investors and Government will want more sophisticated outcomes measures for other types of SII.

The Commonwealth Government should consider making more of its data available, including making better use of, and sharing and linking
The complex nature of social problems means that linking and matching data sets is also necessary to build a fuller picture of the causes and effects of problems and proposed solutions; including causal relationships between services provided and outcomes for clients. Improving data gathering and analysis capability within services and a better interface between Government and non-government data sets will improve the pipeline of potential SII transactions.

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

**Conclusion**

Impact investing will never replace Government funding for high quality social programs; however, there is a clear opportunity to unlock further private sector funding, especially from our large superannuation funds to deliver greater social impact. SVA believes the Commonwealth Government can play a significant leadership role in fostering and growing a diverse social impact investing market which will achieve measurable and desirable social outcomes for all Australians.

A national social impact investing market can be significant in addressing many of the problems our communities face. Through leadership, investment, improved infrastructure, access to good quality data, and social procurement the Australian Government has a unique opportunity to strengthen the SII market in Australia and bring about improved social outcomes for the most vulnerable in our community.

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**End notes**


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