



# A Technical Guide to Developing Social Impact Bonds



March 2011

## Introduction

This guide aims to set out the steps that are required to assess the feasibility of a Social Impact Bond (SIB) idea. It starts with the identification of a social issue where a SIB might be applicable and examines each factor that must be considered if a SIB is to be effective. The guide is written to assist those developing SIBs to reach a stage where it would be possible to establish a contract between a public sector commissioner and investors.

### What is a Social Impact Bond?

- A Social Impact Bond (“SIB”) is a contract with the public sector in which it commits to pay for improved social outcomes.
- On the basis of this contract, investment is raised from socially-motivated investors.
- This investment is used to pay for a range of interventions to improve social outcomes.
- If social outcomes improve, investors will receive payments from government.
- These payments repay the initial investment plus a financial return.
- The financial return is dependent on the degree to which outcomes improve.

## SIB Objectives

Social Finance has created SIBs - an outcomes-based funding mechanism – to provide new investment to improve social outcomes. SIBs fund preventative and early intervention programmes which tackle the underlying causes of specific social problems. Incentives are aligned across public sector commissioners, external investors and service providers, all of whom are acting to achieve improved social outcomes as defined in a contract.

The main objectives of the SIB are to:

- Increase the pool of capital available to fund early interventions;
- Encourage a broad diversity of service providers and collaboration between providers;
- Create more market discipline and offer predictable revenue streams for service providers to enable those that are effective to thrive; and
- Align public sector funding more directly with improved social outcomes.

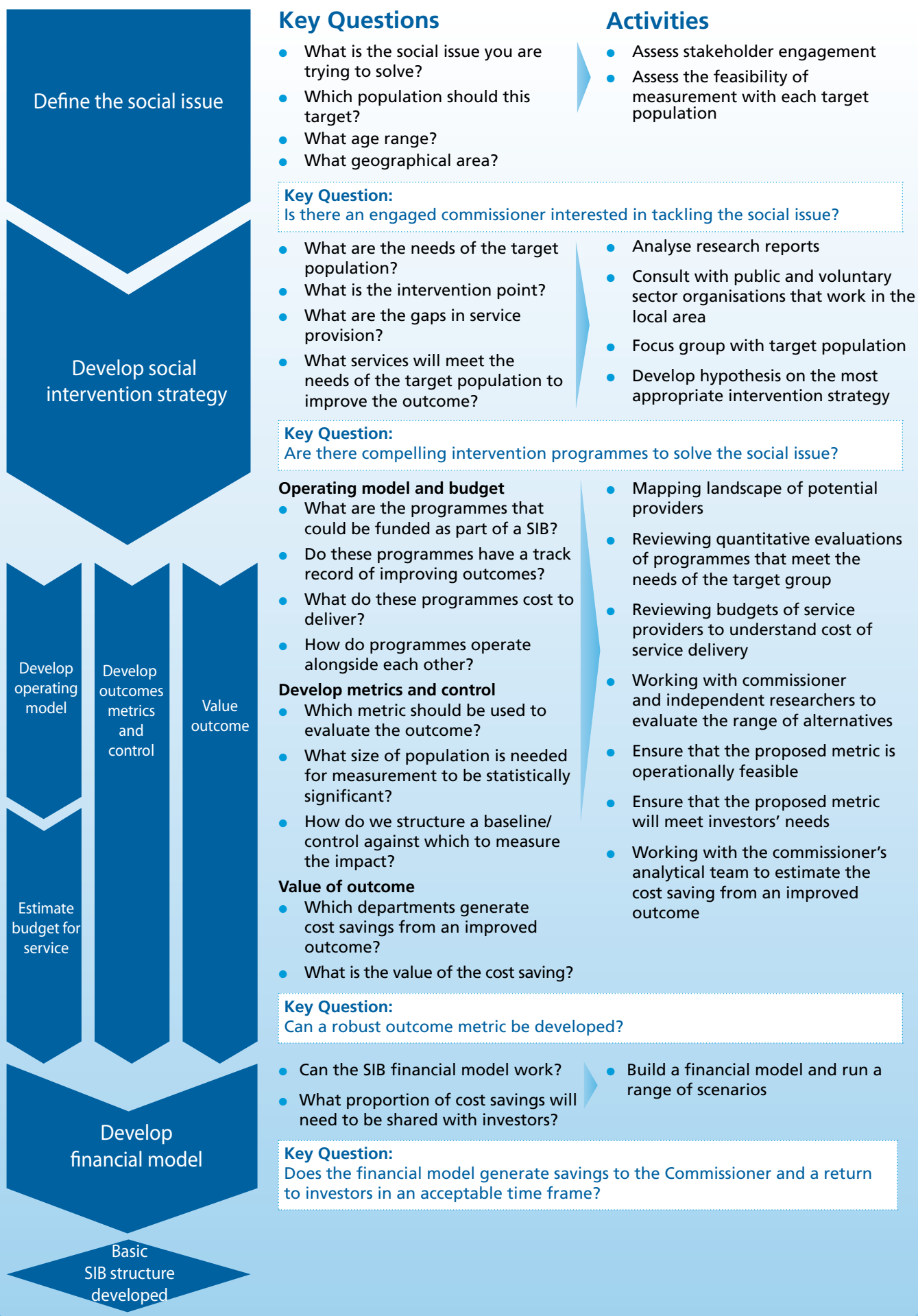
The first Social Impact Bond was launched in September 2010 at Peterborough Prison. It funds rehabilitation services for short-sentence prisoners released from the prison, with the express aim of reducing re-offending. Social Finance is currently exploring a number of potential applications of SIBs in areas such as health, drug rehabilitation, Children’s Services as well as criminal justice.

## Beginning the process

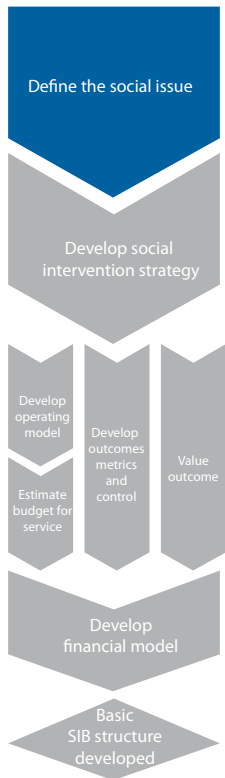
Social Impact Bonds will not apply in all circumstances. In many areas, traditional funding streams will remain the most appropriate. To determine whether a SIB could apply to tackling a specific social problem, a number of factors must be considered. We set out below the various stages of the feasibility assessment process and a series of key questions to be addressed.

**Figure 1** summarises the key components of the feasibility assessment process.

**Figure 1 – Feasibility Assessment Process**



# Defining the social issue



Social Impact Bonds raise investment to alleviate social problems. The SIB funds interventions which address the needs of a target group where there is either no existing provision or the existing provision is inadequate.

*Illustration of a social issue:* Women offenders have different needs from male offenders. Many have a range of complex problems and are caught in a cycle of abuse, victimisation and offending.<sup>1</sup> The majority are also mothers. The provision of support in the community may prevent women from entering custody and reduce the effect on their children and families.

On the basis of the stated social issue, it is necessary to clearly define the target group. It is this group for whom interventions will be funded and outcomes improved. There must be clear criteria against which the target population can be identified and a process through which referrals can be made into the SIB-funded interventions.

*Illustration of a target group:* In the children's services area, a target group could be adolescents aged 10–15 with behavioural problems, who are referred to the Children's Resource Panel of a Local Authority. In health, a target group could be patients at high risk of emergency hospitalisation who are identified through risk assessment tools.

If the definition is not sufficiently focused the interventions may be too diffuse to have a significant impact on the target outcome. If the definition is too narrow, the target population may be too small to demonstrate a statistically significant effect.

A Social impact Bond requires an engaged commissioner who is open to outcomes-based contracting, where payments are made if agreed social outcomes are achieved.

*Illustration of an engaged commissioner:* In developing the Peterborough SIB pilot, the Ministry of Justice was highly involved from an early stage and contributed essential analytical expertise in developing a robust outcome metric. Commissioners in other areas of SIB development could include Local Authority Children's Services, local Drug and Alcohol Action Teams, Department of Health and GP Commissioners.

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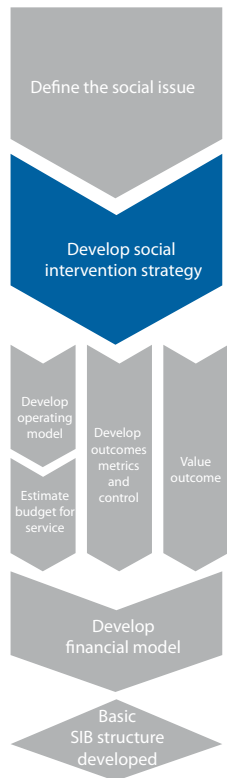
## Key Question:

Is there an engaged commissioner committed to tackling the social issue for a defined target group?

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<sup>1</sup> Short Study on Women Offenders. Ministry of Justice (May 2009).

# Development of the social intervention strategy



Social Impact Bonds look to fund preventative, innovative interventions that tackle the root causes of a range of social issues. Tackling these issues often requires a variety of interventions. For example, drug users might need not only drug treatment services but family support programmes that would reduce their risk of relapse. SIB funding aims to bring together a suite of interventions that are tailored to address specific needs and that reflect the local circumstances in which the programme operates.

To develop an intervention programme, we recommend engaging with national and local service providers to identify where complementary interventions could better meet the needs of the target population and achieve the desired outcome. The SIB funding structure encourages all service providers to work collaboratively towards achieving the target outcome.

To determine the feasibility of the intervention programme for SIB funding it is necessary to establish the impact the programme is likely to have on the target outcome.

This is dependent on two considerations:

- The degree to which interventions are well understood and can be evidenced.
  - *Illustration of evidenced intervention:* the independent evaluation<sup>2</sup> of St Giles Trust’s “Through the Gates” programme was critical in developing the investment proposition for the Peterborough SIB pilot; and
- Whether there is a gap or scarcity of service provision to the target group such that SIB investment is likely to lead to a significant change in the targeted outcome.
  - *Illustration of gap in service provision:* short-sentence prisoners receive no statutory supervision. This lack of support on release contributes to their high incidence of reoffending. Therefore, investment in rehabilitation of these ex-offenders is likely to lead to a reduction in reoffending with the associated benefits to society and the individuals concerned.

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## Key Question:

Is there a compelling intervention programme to solve the social issue?

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<sup>2</sup> St Giles Trust’s Through The Gates: An Analysis of Economic Impact. 10 December 2009. Pro Bono Economics & Frontier Economics.

# Building the business case



Developing the business case for a SIB comprises several parallel work streams which are set out below.

## Developing the Operating Model & Intervention Costs

Given that SIBs are likely to fund a consortia of service providers, it is necessary to have a robust understanding of the total programme delivery costs, including infrastructure and overhead costs. The development of an indicative budget for the proposed suite of services will determine the level of funding that will need to be raised from investors through the SIB.

It is important at the feasibility stage to consider the practical implications of how the SIB can operate. Engagement with a commissioner is helpful to understand how the portfolio of SIB interventions could sit alongside “business as usual” processes.

## Determining the Outcome Metric & Control Group

The outcome metrics form the foundation of the SIB contract between the public sector and investors. All stakeholders need to trust that there is an objective mechanism for assessing and agreeing the degree to which social outcomes have been achieved. Such a metric needs to be linked to cashable savings on the part of the public sector commissioner. Whether suitable metrics can be identified is a key determinant of whether or not a SIB is the appropriate instrument for addressing an identified social issue.

*Illustration of outcome metrics:* in the health sector potential outcome metrics might include a reduction in emergency hospital admissions or a reduction in A&E attendances. In the case of a SIB in Children’s Services, outcome metrics could include an objective indicator linked to cost savings, for example a percentage

change in number of young people entering the care system, alongside a subjective indicator such as a robust index of child well-being.

Care should be taken that the selected metric avoids perverse incentives. In order to measure the direct impact of the SIB-funded interventions on outcomes, a baseline or control group is required. Whether a historical baseline can be used or a comparison group is required depends on the stability of historical data and the availability of a suitable comparable population.

## Outcome Valuation

The outcome valuation for a SIB is the average public sector cost saving resulting from an improvement in the outcome. It should be noted that, for the purposes of analysing the potential returns to investors, the outcome value is narrowly defined in terms of the cost savings accruing to specific public sector budgets.

*Illustration of outcomes valuation:* cost savings accruing to health commissioners due to hospital admissions avoided or local authority social care cost savings due to a reduction in care placement costs.

A quantification of broader social outcomes (e.g. safer communities and fewer victims due to a decrease in drug addiction, lower disruption in patients’ lives due to a reduction in emergency hospital admissions, improved school attainment due to a young person looked after being successfully reunited with his or her family) reflect important social benefits, but do not release cash from public sector budgets that could be used to make outcomes-based payments to investors in a realistic time frame. This may change over time.

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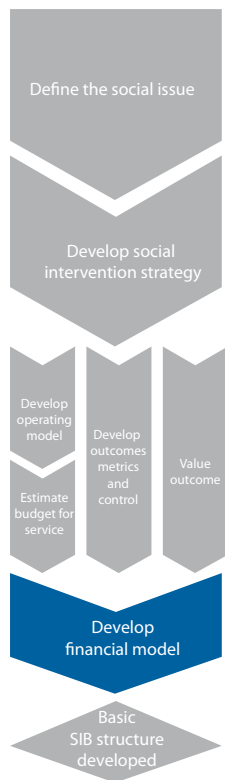
## Key Question:

Can a robust outcome metric and control group be developed?

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# Developing the Financial Model



The financial model aims to reflect the economics of the SIB. It estimates the costs of interventions, overheads and other fixed costs which together determine the level of investment required over the period of the SIB. Set against this will be the share of the cost savings agreed by the commissioner to be distributed to investors should a sufficient improvement in outcomes be achieved.

The financial model requires consideration of three factors:

- Intervention costs
- Outcome values
- Time horizon to realise investment returns

SIBs work when the costs of achieving the target outcome (intervention costs plus overheads and fixed costs) are substantially lower than the level of the resulting public sector savings (outcome value).

This is essential to developing a financially viable investment proposition on which to raise capital.

A reasonable time horizon for the investment is critical. Investors would prefer to see a SIB that matures within a time horizon of around 5 years. Therefore there needs to be a tight timescale between intervention, measurement of impact and payment on outcomes achieved. This is a consideration particularly in examples such as early years intervention (0-5 year olds). If the outcome metric is educational attainment, but it is necessary to wait 11 years (age 5 to 16 years old) to measure GCSE results for the target population, this will not make for a feasible SIB. For such a model to work, an earlier measure regarded as a reliable predictor of future performance is necessary.

The focus on adolescents (aged 10–15 years old) provides a relatively compact time frame over which to measure outcomes. For this age group, research shows that if a young person remains looked after for more than a short time period (e.g. 3 months), the likelihood of remaining looked after on a long-term basis increases. Outcomes for the young person become much worse with long-term care. Therefore one approach could be to measure placement-related outcomes at 3 or 6 months post-intervention.

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## Key Question:

Does the financial model generate savings to the Commissioner and a return to investors in an acceptable time frame?

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## Next steps

We hope the process outlined above is helpful in developing a feasible SIB model. Social Finance would be delighted to engage with you in order to support progress towards implementation. As a first step we would ask you to submit your responses to the key questions set out in the appendix.

For more information please review our publications:

*Towards a New Social Economy – Blended value creation through Social Impact Bonds* (March 2010).

*Social Impact Bonds – Unlocking Investment in Rehabilitation* (September 2010).

We invite you to join the Social Impact Bond forum to connect with other interested stakeholders, or participate in our ongoing series of webinars.

[www.socialfinance.org.uk/forum](http://www.socialfinance.org.uk/forum)

We wish you all the best with your SIB development and look forward to working together.

# Appendix: Key SIB Questions

## 1. Social issue

What is the social issue you are trying to solve?

*e.g. high number of avoidable emergency hospital admissions of patients with long-term health conditions (such as diabetes and asthma)*

What are the systemic causes of this issue?

*e.g. under-provision of specialist support and care in the community to improve the health of patients with long-term conditions*

Are there interventions that have been shown to improve this issue?

*e.g. provision of interventions such as community nurse support, telehealth, self-management education*

## 2. Outcomes

What would the desired outcome of the social impact bond be?

*e.g. reduction in hospital admissions; improvement in the health of patients with long-term conditions*

How would the improvement in the social outcome be measured?

Are there existing objective measures of the outcome?

What is the current outcome for the target population?

## 3. Target population

How would you define the target population who would receive services funded by a SIB?

*e.g. patients in the local area identified as being at high risk of hospital admission due to long-term conditions*

Can you define the target population objectively?

*e.g. application of risk assessment tools*

What criteria would you use to define the target population objectively?

How do we identify people who are in the target population?

How many people are in the target population?

What are their needs?

How does the support need vary across the target population?

*e.g. for different age groups or different conditions*



#### 4. Interventions

What are the proposed interventions to be funded by a SIB? *e.g. better community and primary care services*

What are the proposed organisations to be funded through a SIB?

Is there evidence that these interventions are effective at achieving the desired social outcome?

Is there a quantitative (statistically significant) evidence base?

Has an independent evaluation of the intervention been undertaken?

How have these interventions improved the outcome?

How much do these interventions cost to deliver per person who receives them?

#### 5. Value of the outcome

Which government department(s) will financially benefit if the social outcome is achieved?

How will these cost savings be achieved? *e.g. reduced hospital costs*

How much will the government save if the outcome is achieved?

Are these cost savings cashable? *i.e. can the savings be realised (e.g. through the decommissioning of ineffective services)*

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Social Finance is building a pioneering organisation to develop financial products that marry the ambitions of investors and the social sector. We support social organisations to raise and deploy capital; we work with government to deliver social change; and we develop social investment markets and opportunities.

Many charities and social enterprises face serious financial challenges that stop them from carrying out their work effectively. We believe that, if social problems are to be tackled successfully, organisations seeking to solve them need sustainable revenues and investment to innovate and grow. Our role is to devise the financial structures and raise the capital to enable this to happen.

Social Finance injects market principles into funding in a way that stands or falls on results – both social and financial. Our financial products forge essential links between the market, government and society.

In these times more than ever, there is a pressing need to harness social investment to make a long term difference to society. This is our ambition.

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