



Social Impact Bonds

2022

1

Background

2

Applicability

3

Sales

- **Background - Success Factors**

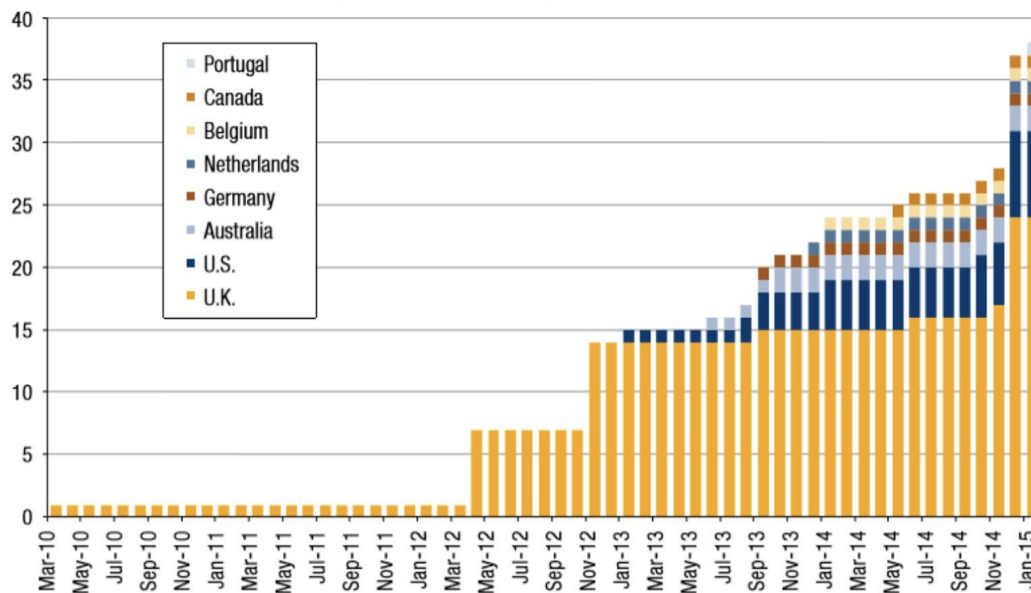
<i>SIB should be Simple</i>	<i>Confine the project to a specific primary outcome within a narrowed scope to ensure the arrangement is manageable</i>
<i>Dedicated Service manager</i>	<i>Dedicated person responsible for day-to-day operations and reporting to project stakeholders</i>
<i>Close collaboration between parties</i>	<i>Between the service provider, investor and contracting body</i>
<i>Early Market Consultation</i>	<i>Both with investors and providers (due to the high level of uncertainty around SIBs)</i>

McKinsey (2012): most promising areas for SIBs are criminal justice and prevention of homelessness

- Background – SIBs have been used in multiple countries and for multiple social areas...

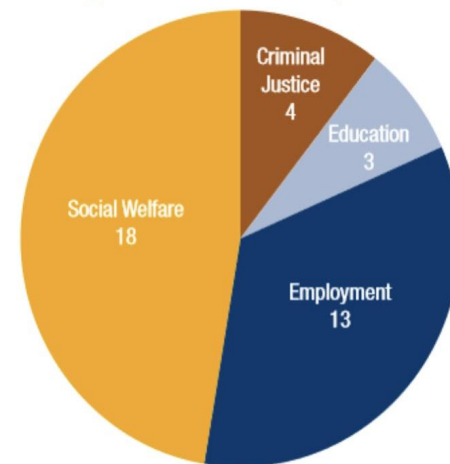
SIBs have been used in multiple countries...

Figure 4. SIB Development Over Time



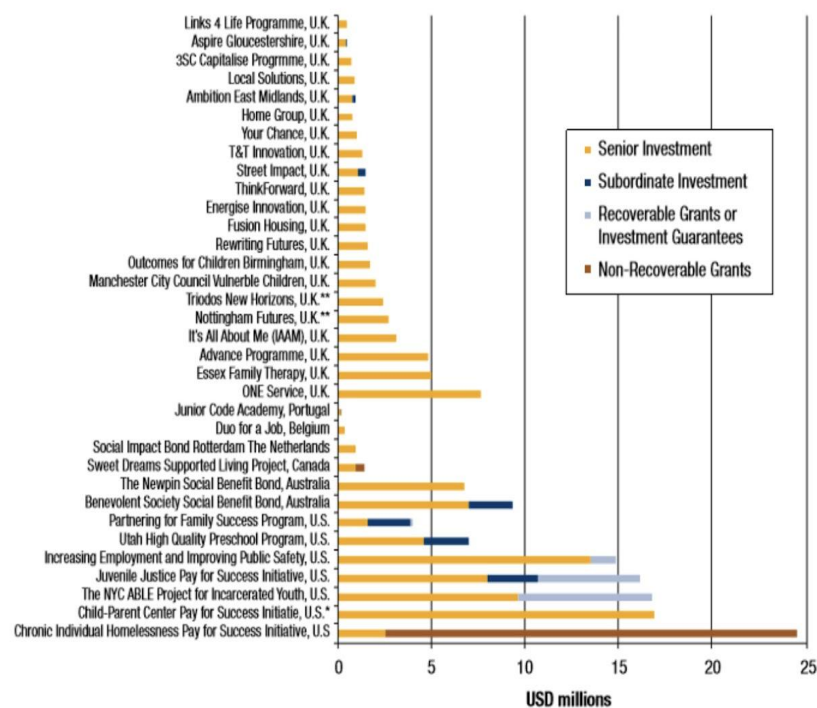
...and for multiple social areas

Figure 5: Active SIBs by Sector



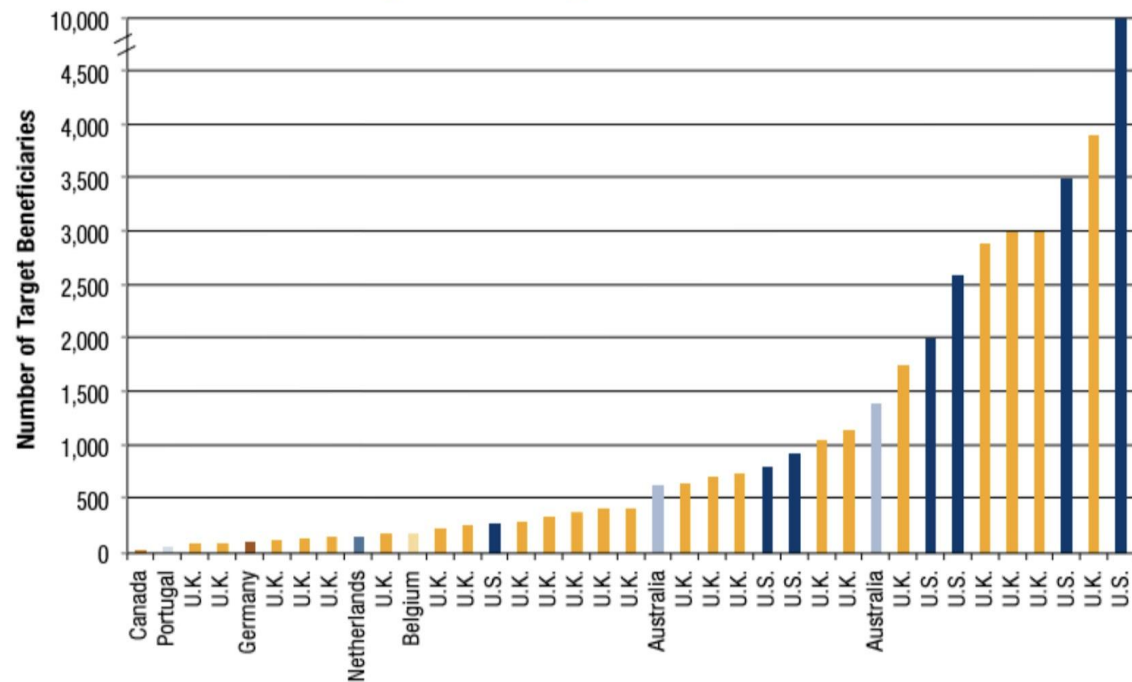
- Background - ...upfront capital commitments...

Figure 7. Upfront Capital Commitment in SIBs

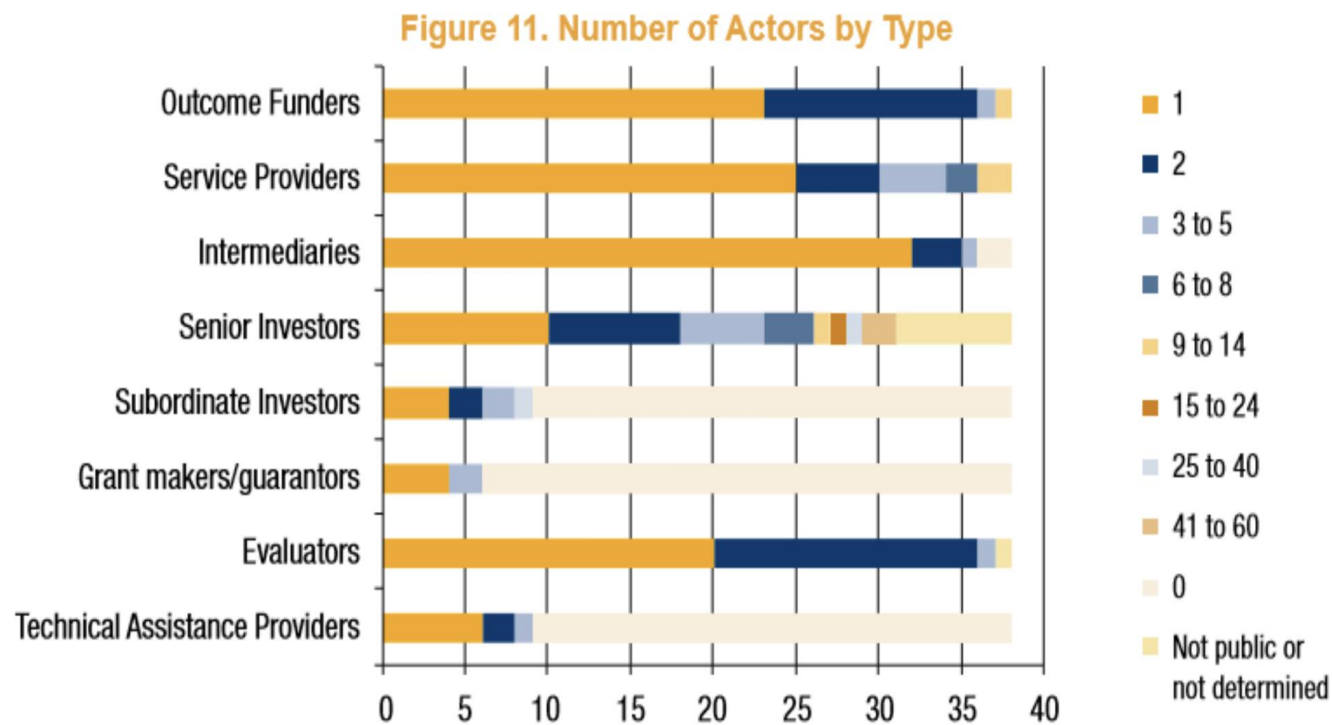


- Background - ...number of target beneficiaries...

Figure 8. SIB Target Beneficiaries



- Background ... and amount of roles involved



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- **Applicability – SIBs has many potential benefits...**

Potential Benefit	Description
<i>Focus on outcomes instead of outputs</i>	<i>Given focus on delivery of measurable results</i>
<i>Savings for taxpayers</i>	<i>Given focus on delivery of measurable results</i>
<i>Access to new and substantial revenue streams</i>	<i>Given financing by private instead of public funding</i>
<i>Shift financial risk to private sector</i>	<i>As currently the risk of unsuccessful investment in social programs is borne by the government</i>
<i>Enhanced impact measurement to be used for other social projects</i>	<i>SIBs require significant investments in data quality and impact measurement practices, potentially to be used by other social projects</i>
<i>New financial product for socially conscious investor</i>	<i>Socially conscious investors will have more options to invest responsibly</i>

**SIBs often result in new investment in social policies,
that the government otherwise likely would not have spent**

- **Applicability – ... however, also several potential disadvantages...**

Potential Disadvantage	Description
<i>Limited number of suitable projects</i>	<i>Limited number of projects that are sufficiently quantifiable and for which there is sufficient evidence / belief that intervention yields results</i>
<i>High transaction costs</i>	<i>Given required extensive negotiations, complex impact measurement and pricing of product (setting up SIB typically takes up to 1-2 years)</i>
<i>Government to pay high risk premium</i>	<i>As investors need to have a reasonable return expectation on their investment, requiring the government to make the conditions attractive</i>
<i>Only 'safe' projects will be chosen / investor bears limited risk</i>	<i>Only projects will be selected that likely succeed given reputational risk for SIBs if the project does not pay off</i>
<i>SIB has inferior characteristics than traditional bonds</i>	<i>SIBs have equity-like risk profile and do not pay back coupons (only pay at end of term in case of success)</i>
<i>Projects face more continuity risk</i>	<i>Cause funding will likely dry up if performance targets are not met, as opposed to traditional government-funded projects that likely continue</i>
<i>Social services to become more expensive</i>	<i>As investment likely creates pressure to start charging for social services</i>

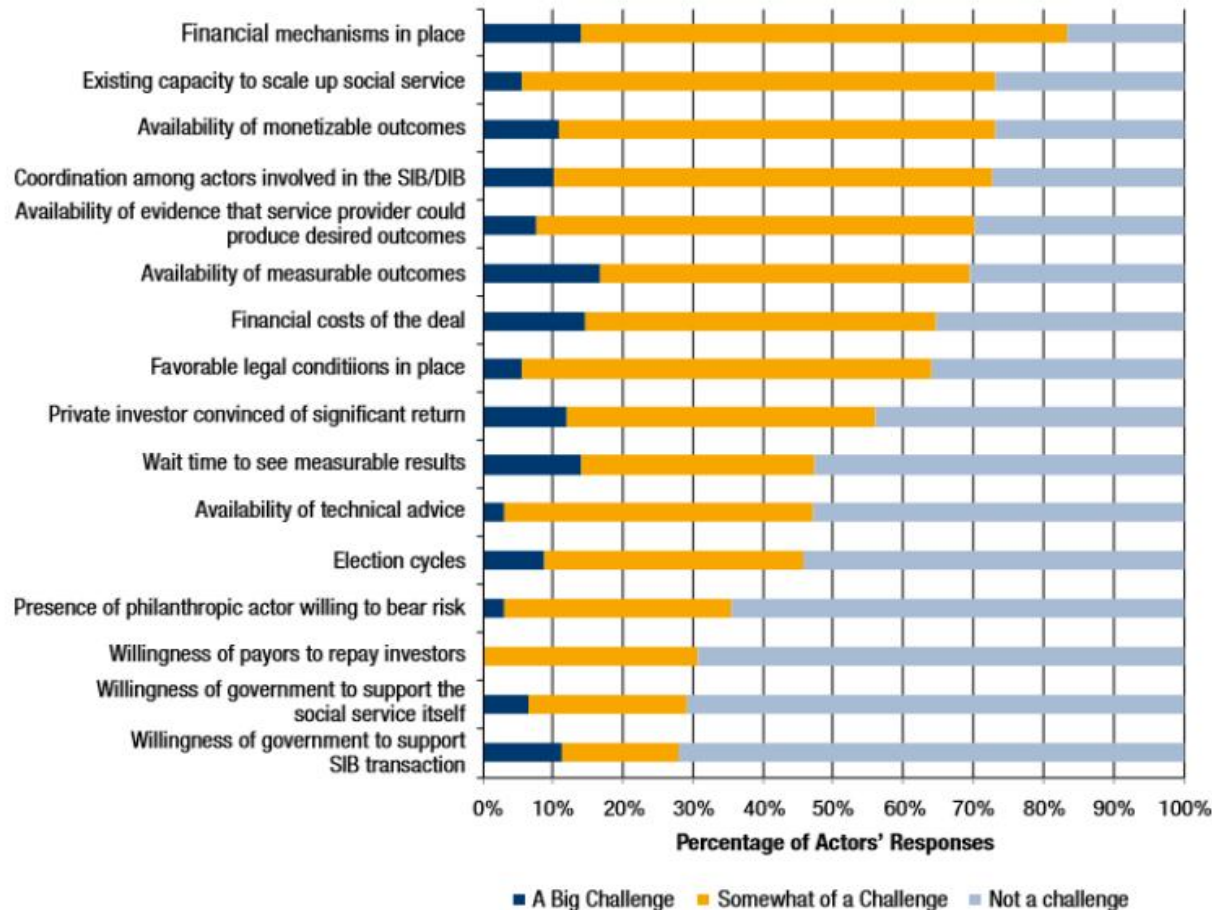
**Due to above disadvantages SIBs might not be as popular as expected
(in fact, many SIBs in the past have not hit maturity in the past)**

- **Deep-dive: Limited number of available projects, as projects need to suffice large number of conditions**

Conditions	Description
<i>Measurable outcomes for defined cohort of service users</i>	<i>Impact of intervention can be tracked and quantified</i>
<i>Limited contractual period</i>	<i>Investors need to have potential to have money returned in foreseeable time period</i>
<i>Clear correlation between intervention and result</i>	<i>Not too many factors should have influence on outcome, Randomness of outcome should be avoided</i>
<i>Value of payment is sufficient reward for risk by investor</i>	<i>Should be significant given equity-like risk profile of SIB</i>
<i>Value of outcome is larger than the costs involved</i>	<i>Otherwise social project is more suitable for generic government subsidy</i>
<i>Gaming of system is not possible</i>	<i>Success or failure should be objective and not be subject to service manager's influence</i>

- Sales - ...And these challenges are confirmed by the different actors

Figure 13. Challenges in Developing SIBs



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- Sales – Bondholder target

Both SIB underwriters and investors are private parties

Underwriters

- Structure the SIBs financially and syndicate out to investors
- Mostly by investment banks so far
 - E.g. Goldman Sachs, Bank of America Merrill Lynch, and Northern Trust

Investors

- Any non-governmental body, but until now mostly high net worth individuals or foundations

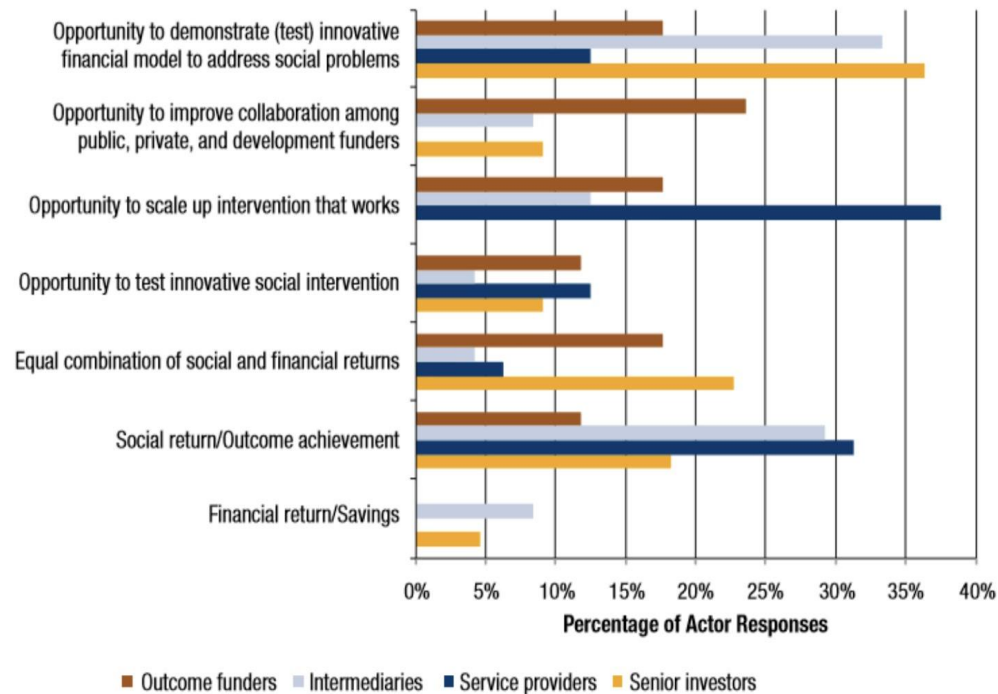
Metaphor

- SIBs are often sold using lightbulb as metaphor
 - All old-fashioned lightbulbs are replaced by LEDs for free by investor
 - If energy savings are sufficient, investors gets significant return
 - If not, the investor would take the lightbulbs back and return the old lighthbulbs

Underwriters and investor are involved in SIBs for both financial and social reasons

- Sales - Different actors are involved in SIBs for different reasons

Figure 12. SIB Actor Primary Motivations



• Sales – Pricing

SIBs can be priced in different ways...

Cost-plus	<ul style="list-style-type: none"> • Cost of intervention¹ + % pre-determined max RoR • Requires minimal info
Market price	<ul style="list-style-type: none"> • Basis supply and demand for SIB <ul style="list-style-type: none"> • Given procurement
Cashable benefits	<ul style="list-style-type: none"> • Based on prediction of free-cash-flow generated
Quantified social value	<ul style="list-style-type: none"> • Especially suitable for projects that do not have significant cashable benefits

...But pricing generally depends on...

...(Perceived) risk	<ul style="list-style-type: none"> • Involves default, event and inflation risk <ul style="list-style-type: none"> • No interest, reinvestment or market risk • Typically large given equity-like risk profile
...Size of upfront investment	<ul style="list-style-type: none"> • Required investment to achieve prognosed impact
...Resources involved	<ul style="list-style-type: none"> • E.g. employee salaries, invested capital, transaction and monitoring costs, etc
...(Expected) time to maturity	<ul style="list-style-type: none"> • As investors hold SIBs for their duration <ul style="list-style-type: none"> • There is no secondary market (yet)

Optimal pricing is a mix of above methods and factors