Social Investment Agency
Toi Hau Tāngata

BRIEFING

Social Investment Fund – sources and application of funding

Date:	13 September 2024
Security level:	~~Budget Sensitive~~
To:	Hon Nicola Willis, Minister for Social Investment
Tracking Number	SIA24/25-068

Purpose

This report seeks your agreement to the high-level Crown funding arrangements for the Social Investment Fund (the Fund), and to seek an invitation to submit a Budget 25 initiative that establishes these arrangements. This report does not address potential funding from third party investors: these options will be developed once the Fund is in the establishment phase.

Context

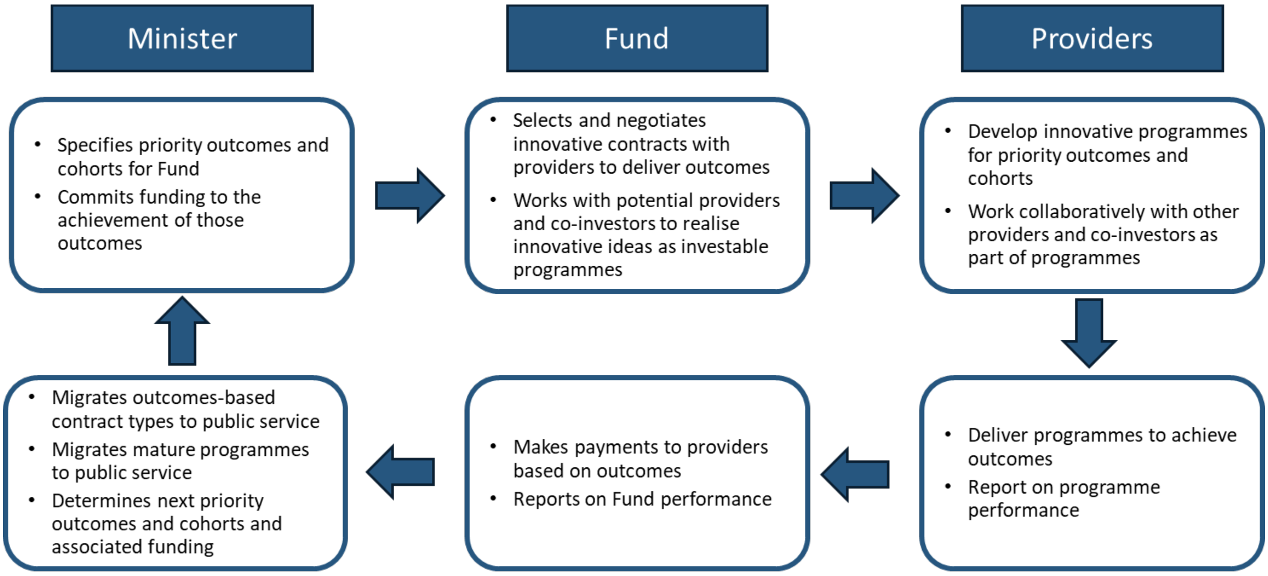
1. Overall, we envisage the Minister for Social Investment will signal priority outcomes and cohorts, and the Government's willingness to pay for those outcomes, aligned with the Government Targets. The Fund will respond to those incentives and give effect to that direction. It is anticipated that the Fund will be established as a Crown company that catalyses innovation in the social investment system, and directly commissions for outcomes.
2. The Fund will drive positive change for vulnerable New Zealanders and accelerate change across the social sector, through the application of social investment methodologies. In particular, it will:
    - Improve outcomes for participants as a direct result of the success of programmes it commissions, and the opportunity to migrate successful programmes into the Public Service once they are established at scale.
    - Demonstrate what works through these programmes, to encourage, enable and inform better outcomes across the Public Service.
    - Develop outcome-based contracting tools and capability that can be adopted more widely by the Public Service, to work more effectively with providers and co-investors.

- Leverage the Crown's investment in the Fund and enable wider social investment by philanthropy, iwi, and commercial investors to achieve greater impact, and to work towards a thriving social investment eco-system.

Overview of the operation of the Fund

3. Figure 1 outlines the roles of the Minister, Fund and Providers to summarise how the Fund could apply a social investment approach. The Agency's primary role in this framework would be to support the Minister: providing advice on priorities and funding, and monitoring the performance of the Fund (both narrowly within this framework and more broadly for the impact of the Fund to accelerate change across social services).

Figure 1: How the Fund could work



4. The central feature of this framework is that the Minister commits the Government to pay for priority outcomes and cohorts over time, and the Fund seeks to best achieve those outcomes within the funding provided. This arm's-length structure gives the Fund freedom to develop innovative ways of working with providers and other investors, and the ability to assemble a portfolio of programmes/investments to deliver those outcomes.
5. A challenge for this model is that there is not a commercial return on outcomes. Rather, the Government is committing to pay for the achievement of those outcomes, and the Fund is dependent on that funding from the Government to provide its return. While commercial structures and incentives can be created for the Fund, it cannot be financed solely from the returns on its investments and, instead, will remain reliant on ongoing government funding in some form (for example, Funding Agreements to provide a stream of operating funding, or regular equity injections for the Fund's operating expenditure and/or outcome payments).

6. Similarly, social sector providers are not purely commercial in nature. They are not seeking to maximise their profits, rather they are motivated by the outcomes they can achieve for the people they serve, while remaining financially sustainable. Outcomes-based contracting through the Fund unlocks this underlying motivation, enabling innovation and allowing providers to focus on what works, rather than being constrained by the inputs and outputs specified in traditional contracts. An important principle of social outcome contracts is that providers should benefit from the value of outcomes achieved, building 'balance sheet' capacity and risk appetites to further participate in the social investment system.
7. It is also likely that at least some priority outcomes and cohorts will be for vulnerable New Zealanders with highly complex social issues. There are significant challenges in disaggregating and attributing the changes in outcomes to specific programmes and interventions, in the context of complex, multifaceted, interconnected and intergenerational issues. Our understanding of these dynamics, and of the outcomes being achieved, will continue to improve over time, including as the investments of the Fund themselves generate new information on "what works" (for whom, when, where and why).

Types of funding that may be required

8. Figure 2 summarises the different types of funding, and examples of where they may be required in the context of the Social Investment Fund. We anticipate that a range of different expenditure types will need to be provided, depending on the activities undertaken by the Fund, the nature of the Crown's relationship with the Fund, and the role of the Agency. Flexibility will also be needed to rebalance the mix of funding over time, as the Fund matures.

Figure 2: Funding for potential Social Investment Fund activities

Departmental output expenses	• Design and establishment costs • Agency costs – advice and monitoring
Non-Departmental output expenses	• Operating costs for Fund entity • Capability building – e.g. funding to providers or as operations of Fund • Payments for services (output-based contracts/components) • Payments for outcomes (result-based contracts/components) • Provisions for quantifiable contingent liabilities
Non-Departmental other expenses	• Non-recoverable grant-type funding
Non-Departmental Capital expenditure	• Equity injections for Fund's operating expenditure and/or outcome payments • Capital contribution to acquire assets (e.g. social infrastructure, or an ownership interest)

9. At this stage, we would anticipate establishing a Multi-Category Appropriation (MCA) to commit funding across the forecast period and into out-years. This long-term funding envelope reflects the timeframes for realising outcomes, and ensures the Fund can itself contract over suitable time periods. An MCA provides flexibility to manage the overall funding provided across the different funding types, and to rebalance as needed (e.g. from operating to capital).
10. There may also be a case for the Minister of Finance to issue Crown guarantees in respect of the Fund's activities. These guarantees will create contingent liabilities in respect of outcome payments or borrowings from third party investors. In general, where a liability can be measured with sufficient reliability, it is recorded in the financial statements and provisions are made at the best estimate of the expenditure required to settle the obligation. Contingent liabilities are also quantified (as far as possible) and are separately disclosed, where they exceed $20 million. A Crown guarantee for any debt the Fund might raise in the future, if desired, would reduce the cost of funds significantly (towards the core Crown's cost of capital), and would lower financing costs for investments in social enterprises and social infrastructure.

Aligning funding and accountability

11. There are three broad models for the Minister to provide funding to the Fund, outlined in Figure 3. These are not mutually exclusive, and it is likely that multiple funding streams could operate at the same time, and that the mix of funding streams would evolve over time. All three reflect an overall principal-agent relationship between the Minister and the Fund, enabling the Fund to work flexibly with providers and potential investors.

Figure 3: Three possible funding models

1. Payments to the Fund for specific purposes and activities	**2. Outcome-based payments to the Fund**	**3. A stream of equity injections for the Fund's expenses**
Appropriation specifies the scope and purpose for the funding. Fund is limited by the appropriation on how that funding is used. Appropriation also limits contracts between Fund and providers.	Appropriation specifies the outcomes to be achieved with the funding: with more detail in a Funding Agreement. Fund as intermediary can engage providers and partners in any way, as long as its portfolio of investment achieves the specified outcomes.	Capital appropriation provides equity injection to Fund, to meet its operating costs: as provided in the subscription agreement. Would need to commit to a stream of equity injections for at least 5-10 years, to allow Fund to contract and partner effectively.
Can be used to provide for the operating costs of running the Fund. Can be used to specify services to be purchased (more traditional output-based contracts).	Can be used to provide outcome-based payments to the Fund, on achievement of outcomes. Agnostic on how the Fund achieves those outcomes.	Can be used for any purpose, limited by the overall aim/purpose for the Fund. In effect, committing to pay the Fund upfront in expectation that it will deliver outcomes.
In effect, Tight-Tight-Loose: • strong control for Minister • limited flexibility for Fund and providers to innovate • limited focus on outcomes or performance	A Tight-Loose-Tight model: • Clear specification of outcomes to be achieved • Significant flexibility for Fund and providers to innovate • Payments to Fund depend on successful delivery of outcomes	Broadly, Loose-Loose-Medium: • High level direction from Minister • Significant flexibility to innovate • Fund's ongoing operation (and further funding) depends on successful delivery of outcomes.

12. These options can operate together, to reflect different aspects of the relationship between the Minister and the Fund:
    - Option 1 provides more traditional funding limited to specific purposes, which may be suitable to provide for the operating costs of the Fund, or where the Fund is purchasing specific services.
    - Option 2 uses Funding Agreements to specify the outcomes to be achieved by the Fund and the payments that will be made in return. This gives the Fund and providers significant freedom to innovate, while maintaining strong discipline on the Fund to ensure its portfolio of investments delivers the outcomes required.
    - Option 3 commits to a stream of equity injections for the Fund's costs for at least 5-10 years. This gives the Fund greatest freedom to innovate within its overall aim and purpose. The Fund will need to demonstrate it is achieving outcomes in order to attract further funding and to continue to operate.
13. In this context, an important dimension of choice will be the extent to which the Minister can fully specify outcomes and associated payments for the Fund ex-ante and arm's-length, relying only on the Funding Agreements or conditions attached to equity injections. The alternative

would be to maintain a closer relationship with the Fund to update and refine expectations regularly. We will provide further advice on options along this continuum, as part of Briefing Four which will provide substantive advice on proposed entity form for the Fund.

Sources and scale of funding

14. Recognising fiscal constraints, funding will need to be identified through reprioritisation or other savings measures to offset the cost of a Budget 25 initiative for the Fund. Initial discussions with the Treasury suggest that funding for this initiative should come from general budget funding – including the savings generated from overall reprioritisation.
15. We have tried to estimate the "minimum viable product" for the size of the Fund to be credible and meaningful as a catalyst for innovation across the social sector. Too small and the Fund will be irrelevant, generating a small number of special cases that show promise but have little wider impact. Too large and the Fund will create excessive fiscal pressure and may result in the Fund expanding into less innovative programmes – as there will be limited capacity for genuine innovation, in particular initially.
16. Our best estimate is that the minimum necessary scale to be a meaningful catalyst for innovation would be for the Fund to start with around 1 per cent of relevant expenditure – and accumulate to around 5 per cent over time.
17. The Fund's activities will be closely related to (part of) the expenditure on social services commissioned from non-government providers, which is estimated at $6 to $7 billion each year. In addition, some services delivered by government agencies are a close substitute for contracted services (for example, some navigator and some social worker roles in the public service). On that basis, we would suggest committing around $60 to $80 million per year to the Fund – over the forecast period and into outyears – in Budget 25.
18. Maintaining similar commitments over the next four or five Budgets would result in a Fund that is delivering outcomes worth around $300 to $400 million each year and into outyears: a significant, material driver of innovation, accounting for around 5 per cent of commissioned social services.
19. An important consideration is whether the Fund would 'call' this funding in advance of making outcome payments (and hence have funds 'on-hand'), or whether payments would be made to the Fund as outcomes are achieved. This will be explored further in the advice on appropriation structure and funding models as part of the Budget 25 initiative.
20. We understand some specific sources of funding are also being considered – for example, the proceeds of crime and the Best Start payments. It would be possible to ensure the Fund has similar priority outcomes and cohorts – so that this specific reprioritisation will achieve more and better outcomes in those areas.

Strategic areas for investment by the Fund

21. We will provide further advice on the proposed approach to progressing strategic areas for investment by the Fund in Briefing Six, which will be provided to you by 4 October. This can help to build momentum and buy-in for the Fund, and the development of a forward pipeline of potential future programmes and partners.

22. There is work underway to develop exemplar outcomes-based contracts for social investment, and to identify initiatives applying a social investment methodology for Budget 25. As these are developed, there is the potential for one or more of these contracts and initiatives to be progressed as part of the work on the Fund. There will also be opportunities for the Fund to adopt these contracts and investments, should that be appropriate, once it is established.

Next Steps

23. As recommended in this briefing, the next step would be to seek an invite for a Budget 25 initiative to provide funding for the Fund. The Agency would prepare an initiative following Treasury's template and guidance, and to the deadline for submission, likely, in December. The appropriation arrangements, funding types and associated agreements for the Fund will be further developed through this initiative and the Budget 25 process. The Agency will also work with the Treasury to confirm reprioritisation and other savings within the Budget 25 process to meet the costs of the Fund.

24. In parallel, Briefing Four will provide substantive advice on the entity form for the Fund (by 19 September). Briefing Five will provide further advice drawing together the detailed design and implementation of the Fund (by 26 September). Briefing Six will provide advice on the approach to progress strategic areas of investment for the Fund (by 4 October).

Recommendations

It is recommended you:

Note that an arm's-length Crown company will require an appropriation to provide for its activities.		
Agree that this appropriation should be established in Vote Social Investment.	☐ Yes	☐ No
Agree that this should be a new Multi-Category Appropriation to allow for a range of possible funding types, depending on design of the Fund and its relationship to the Minister.	☐ Yes	☐ No
Agree to seek an invitation for a Budget 25 initiative to capture the changes to appropriations needed for the Fund.	☐ Yes	☐ No
Note that the types of funding providing to the Fund – through this appropriation – can be finalised as part of the Budget 25 initiative.		
Note that the Agency is working with the Treasury to identify sources of reprioritisation to meet the costs of the Fund, and that this may constrain the scale of the Fund.		
Note that the Agency will provide further advice on the entity form for the Fund, the design and implementation of the Fund process, and strategic areas of investment for Fund.		

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Attachments

No attachments.