Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>[1]</td>
<td>to protect the privacy of natural persons, including deceased people</td>
</tr>
<tr>
<td>[2]</td>
<td>to protect the commercial position of the person who supplied the information or who is the subject of the information</td>
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<tr>
<td>[3]</td>
<td>that the information requested is or will soon be publicly available</td>
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<tr>
<td>[4]</td>
<td>to prevent the disclosure of official information for improper gain or improper advantage</td>
</tr>
</tbody>
</table>

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.
Office of the Minister of Finance
Office of the Minister for Social Development
Chair, Cabinet Social Committee

The first New Zealand Social Bond: Mental Health and Employment

Proposal

1  This paper seeks approval to enter into the first social bond for New Zealand designed to improve the employment outcomes for those with mental health conditions. If agreed by Cabinet, an outcome agreement will be countersigned with the service provider which in turn will trigger issue of the bonds. Only once capital is raised can the bond proceed with services seeking to commence on 1 February 2017.

Executive Summary

2  Social bonds are an innovative form of contracting for social outcomes, where governments utilise private sector skills to drive innovation in service delivery while also managing associated risks. Internationally their use is small but steadily growing: there are now some sixty bonds underway in a range of countries. Australia has three operational bonds and new options are actively being considered in four states. Cabinet agreed in August 2013 to begin exploration of social bonds in New Zealand [SOC Min (13) 19/4 refers].

3  The first proposed New Zealand social bond is designed to improve the employment outcomes for those with mental health conditions, delivering reduced welfare dependence and improved mental health outcomes. If agreed (and private finance raised) service delivery will start in February 2017 and last for five years.

4  This bond is small, with a maximum of outcome payments from the Crown and requiring $1.5m private investment. The small size and operational characteristics mean it has been able to develop a bond with a more simplified and streamlined structure than was envisaged at the commencement of the social bonds pilot programme. Compared with some bonds, the degree of service innovation involved is relatively low. However it offers significantly improved employment and mental health outcomes compared to existing alternatives, and very large overall benefits to the Crown (benefits are five times larger than costs). These are achieved at costs less than alternative interventions while also offering greater potential upside improvements and reduced risks to the Crown.

5  Officials are satisfied that risks are low for the Crown. In particular, by requiring clear identification of an active link between participants and their general practitioner, there is a mechanism that minimises risks of situations where work might reduce mental health. Payments are largely driven by the level of success in employment placements and do not involve Crown warranties or guarantees, beyond a commitment to refer relevant clients to the social bond service provider from six Auckland MSD offices.
To improve potential interest in the bonds, the $1.5m of private investment is split into
two classes. On base case assumptions, less risky Class A capital is expected to return
7%, and more risky Class B 13%. The contract caps maximum potential yields at 9%
and 17% respectively (with any surplus returned to the Crown). Downside risks are also
considerable, with early termination only possible after yields have dropped to around
3% on Class A and -19% on Class B.

If agreed by Cabinet, there are still several steps before the bond can proceed. The first
step will be acceptance by the Crown of the outcome agreement offered by the service
provider. This will trigger the formal issue of the bonds. Only once the bonds are fully
subscribed can the bond proceed. The service provider and officials are reasonably
confident this can all take place by the expected service start date of 1 February 2017.

Funding for the outcome agreement can be provided from the contingency already
established for social bond pilots.

Once operational, the outcome contract will be administered by MSD, as the intervention
deals with job seekers on benefit, and is similar to MSD’s current Work-to-Wellness
contracts.

**Background**

Social bonds are still a relatively new form of contracting by governments to deliver
social outcomes. The bond arrangements mean governments utilise private sector skills
to drive innovation in service delivery while also managing associated risks.
Internationally their use is small but steadily growing: there are now some sixty bonds
underway in a range of countries. Australia has three operational bonds and new options
are actively being considered in four states.

Typically a social bond provides for variability in the level of outcomes that are to be
achieved, with associated changes in the financial return. The greater the improvement,
the higher the returns for investors and better results for the community.

Use of a bond with its capital funding and multi-year contract gives providers the
freedom to deliver services in the best way to achieve outcomes. At the same time,
shifting the financial risk and reward for service performance to investors means a
greater incentive for these groups to apply their resources and expertise to designing
and managing services in ways that make a difference.

In August 2013 Cabinet agreed that procurement begin for a social bonds pilot in New
Zealand [SOC Min (13) 19/4 refers].

Following an approach to the market through a two-stage Registration-of-Interest
process in December 2013 and February 2014, seven proposals were evaluated. Followed
the matching up of financial intermediaries with service providers, four topics
were selected for further consideration for the social bonds pilot. Following further
evaluations, two topics (outcomes) were prioritised as the first two social bonds to be
developed further through the procurement and negotiation process, getting more
people with mental health issues into and keeping work; and reducing youth reoffending
rates in South Auckland.

In June 2015, officials began working closely with a consortium, including a service
provider and financial intermediary, to establish a Mental Health and Employment social
bond. Negotiations were well advanced when the consortium unconditionally withdrew from the process in mid-2016 (as was the right of any party in the process).

16 In order to make progress quickly with the pilot an alternative simplified process was designed. Following probity advice, the Social Bonds team found a replacement provider which operated in mental health and employment services and which had also expressed interest earlier in the process.

17 The Social Bonds team has now reached formal agreement with this new service provider to provide interventions to support job seekers with a diagnosed mental health condition into sustained employment on the basis of a social bond arrangement.

18 Concurrently, the discussions are continuing with another consortium for a possible second social bond reducing youth reoffending rates in South Auckland.

Core services and outcomes delivered by the bond

19 In summary, the social bond (and the associated outcome agreement) involves:

- Assessment, placement, support and other specialised services that helps jobseekers, receiving a Main Benefit and who have a diagnosed mental health condition, find and stay in work. These services will be delivered by an experienced for-profit service provider, APM Workcare Ltd.
- Provision in the pilot is restricted to six Auckland suburbs of Manukau, Manuwera, Clendon, Papakura, Pukekohe and Waiuku
- A contract that runs for five years from the commencement of the agreement (currently proposed to be 1 February 2017, subject to approval and finance).
- Capped service volumes, where a maximum of 1,700 participants are paid for over the five year period

Comment

20 While the total potential cost to government from this social bond is well below the threshold required for a business case, the analysis below utilises the framework of the better business case approach to identify key issues.

Strategic and Economic Case

21 The bond is designed to deliver reduced welfare dependence and improved mental health outcomes, consistent with the wider social investment approach and BPS result one- reducing welfare dependence.

22 Generally social bonds are used as a means of harnessing private sector skills to drive innovation and improve service performance. They encourage the design of new or improved services and then couple delivery with private sector incentives and disciplines so that performance is managed to maximise outcome delivery. For this social bond the degree of service innovation involved is relatively low, as the service model is fairly
similar to that used by the provider in a similar set of Work-to-Wellness contracts (the existing standard MSD contract for assisting jobseekers with mental health conditions into work). There will be some service level innovations (e.g. a newly developed initial assessment tool used to identify optimal support and placement) but these are anticipated to be relatively modest. Rather, the bond shifts incentives and risks more clearly to the private sector than existing contractual arrangements, supporting better outcome achievement.

Crucially, the bond’s base case or expected performance occurs when 43% of the referred clients are placed in employment. This compares with a counterfactual where 10% find employment without any interventions, and a 30% target for the main comparable MSD intervention, Work-to-Wellness contracts.

Crown cost benefit

In contrast with many overseas social bonds, benefits from this social bond comprise a set of direct and easily measured outcomes. These benefits arise as referred participants are placed into work and no longer receive a job-seeker benefit payment. Although there are health benefits as wellness improves for those with mental health issues through appropriate labour market participation, these benefits are less easily measured. A conservative approach has been used for the analysis of this social bond, where savings only include the direct benefits from benefit cessation and expected income tax gains from work. Savings are only attributed during the bond’s life and capped after two years’ employment for any participant, so they do not include gains from those who stay in even longer term employment.

The payment structure used in the bond means the Crown bears minimal risk, almost all payments are generated by successful work placements resulting in benefit exit, and benefits are counted only where in excess of the expected counterfactual. While the payment arrangements are deliberately simplified, on average the Crown is expected to receive measurable benefits five times the size of costs: the base case 7 year net present value (NPV) of benefits is some $15m for payments with an NPV of $3m.

Private investment of $1.5m is required, with investment split into two classes: $1.2m in less risky Class A capital, and $300,000 in more risky Class B. At the base case, or expected performance, this will generate returns to Class A capital of 7%, and 13% for Class B.

The bond incentivises greater achievement of placements into work and for longer durations, where this translates into higher rates of return to investors in the bonds (and similarly lower success results in lower returns). For a variety of reasons, particularly given the pilot status of this social bond, the project team has negotiated a set of capped maximum permissible returns: the contract caps maximum potential yields at 9% and 17% respectively (with any surplus returned to the Crown). Downside risks are also considerable, but the contract permits early termination in circumstances where clients are clearly not being well served, with termination possible by either party after yields have dropped to around 3% on Class A and -19% on Class B.

Some comparison can be made with the Work-to-Wellness (W2W) contract recently tendered in 5 locations by MSD, also supporting jobseekers with mental health conditions into employment. The payment structure used also incentivises longer placements although there is a greater level of input related payment than in the bond.
Given these contracts have only been awarded from July 2016 it is too early to evaluate comparative success.

Both the bond and W2W pay for employment outcomes but they use differing structures and payment arrangements. W2W sets a target for off-benefit at 30% compared with 43% in the bond, but also pays for increased work capacity at a lower level than the bond (less than 15 hours per week). The bond creates more incentives on the provider to achieve longer placements, although W2W payments possibly align more directly to long-term welfare dependency reductions as payments are made only for continuous work placements. The bond pays for all months worked (capped at a maximum of 12 within a two year period from enrolment). The bond achieves its outcome at a lower cost to the Crown. [2]

There is value in running two approaches to incentivising employment alongside each other, providing useful insights into the most effective welfare reductions. A full comparison will also be affected by the mix of part and full time placements and the pattern of work. This will require a thorough evaluation at the end of the bond’s life to measure comparative costs and benefits.

Financial case

As covered above, initial costs for the service are covered through private investment so the Crown effectively pays out a small proportion of actual cash benefits received. Given that the bond is a pilot, it is proposed that payments are drawn from the Social Bond contingency, where funding is transferred to MSD as the agency administering the actual outcome contract. The final level of payment depends on performance, [2]

Payments would be made depending on verified enrolment and employment outcomes.

Commercial and management cases

Following the shortened procurement process the Social Bonds team, working closely with The Treasury and MSD, has now negotiated a final outcome agreement with the provider, APM Workcare, conditional on Cabinet agreement and finance. If Cabinet supports the proposal, officials will countersign the agreement and work with the provider to ensure final bond elements (including raising finance) are achieved in time for service delivery from 1 February 2017.

APM Workcare is a New Zealand registered company supplying a range of vocational rehabilitation and employment services, particularly for people with a disability, injury or health condition. It was established in 2011 by its Australian parent company and now employs around 130 FTEs in New Zealand, through rapid growth across several government contracted areas (primarily MSD, ACC), and has now provided help to more than 36,000 New Zealanders. In recent tendering for mental health and employment services APM won competitive tenders across New Zealand to provide around [2] of overall volumes.
Given that the services provided under the bond are similar to W2W contracts administered by MSD, the outcomes sought are primarily employment and a reduction in welfare dependency, and the inevitable close interaction between MSD and the service provider over referral and verification, officials have concluded that MSD is the appropriate agency to handle ongoing administration of the outcome agreement. MSD has accepted this role (if arrangements are confirmed) but has identified the need for additional resourcing to manage this one-off contract, estimated at [3] This cost has been included in the recommendations of this paper.

Finance: Following signing of the outcome agreement (which is conditional on finance), APM Workcare will proceed with issuing bonds for $1.5m the required. At this stage firm indications of interest have already been received for 60% of the bond amount, including from APM in the most risky class of capital. The Social Bonds team and APM management are relatively confident that finance can be raised, but if funding is not raised by 30 January 2017 the outcome agreement will lapse. In that situation the Crown and APM Workcare would need to consider whether a time extension was warranted. If a time extension is not warranted, then the outcome agreement will lapse and the bond will effectively terminate. Overall the process of finding investors has been difficult. The bond is for a relatively small amount and it has performance characteristics that distinguish it from typical bonds or equities. For most fund managers this means a higher degree of due diligence is required which is not matched by the small scale of the bond.

Benefits realisation/evaluation: Agencies are still considering the scope of potential evaluations that would be useful for this pilot covering contract review, outcome success in both mental health and reductions in welfare dependency, and of the social bond mechanism. Further consideration is required but officials have discussed the key minimum data sets required that would inform subsequent evaluations (most notably linked data identifiers, agreements for data use and supply of data into the IDI) and provided for these in the outcome agreement.

This bond is one of two included in the current pilot programme. Development of a robust value proposition and associated outcome agreement for the second pilot (reducing youth offending in Auckland) has been more involved than initially expected, and any proposal will also need to take into account other emerging changes and proposals in the relevant youth justice areas. The Social Bonds cross agency steering group\(^1\) will review progress and prospects before Christmas. If a bond was still a prospect, it is anticipated it would be completed before June 2017 following further consideration by Ministers and a Cabinet decision.

Officials will provide a full evaluation of lessons learnt from development of the bonds as a final part of the pilot programme. This evaluation will draw out the lessons from the process to date, and compare the experience to date against the original objectives. Other evaluations of this bond during its life will also be required to review the performance of the contract. Details of these evaluations will need to be established at a later stage but officials have agreed that a financial contingency of [3] should be established for MSD to carry out an expected set of two evaluations (mid point and end), subject to the scope of the evaluations being agreed with Treasury’s Commercial Advice Manager. Final decisions on release of the contingency would be made jointly by Ministers of Finance and Social Development.

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\(^1\) Social Bonds cross agency steering group comprises officials from Ministry of Health (chair), The Treasury, Ministry of Social Development, NZ Police, Ministry of Justice, and Ministry of Vulnerable Children
Consultation

39 The Social Bonds team at the Ministry of Health has led the development of this paper in consultation with The Treasury and the Ministry of Social Development. The views of all agencies are reflected in the paper.

40 The Department of the Prime Minister and Cabinet has been informed.

Financial Implications

41 A tagged contingency to fund the social bond pilots was established in Budget 2015, and renewed in Budget 2016. The recommendations in this paper are to fund the social bond pilot from this tagged contingency. This will entail establishing two multi-year appropriations in Vote Social Development for the period 1 February 2017 to 30 June 2021, with two further multi-year appropriations to be sought at a later date for the final two years of the six-year contract, using the unspent balance of the first two multi-year appropriations.

42 A further [3] from the social bonds tagged contingency will be set aside for two evaluations of the mental health and employment social bond.

Human Rights

43 The proposals in this paper are not inconsistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative Implications

44 This proposal has no legislative implications.

Regulatory Impact Analysis

45 A regulatory impact analysis is not required as this proposal does not involve regulatory options.

Gender Implications

46 This proposal has no gender implications.

Disability Perspective

47 The target population for the service to be provided through this Social Bond pilot programme are people with a diagnosed mental condition. Evidence from the literature and New Zealand experience supports the likelihood that health and welfare outcomes will be improved through appropriate work participation for clients and their families.

Publicity

48 All publicity around this social bond will be led by the Ministers of Finance and Social Development, subject to any necessary pre-agreement with APM Workcare. Officials suggest that any announcements are made once finance has been secured.
Recommendations

The Minister of Finance and Minister for Social Development recommend that the Committee:

1. note that in August 2013, Cabinet agreed that procurement begin for a social bonds pilot in New Zealand [SOC Min (13) 19/4 refers]

2. note that following an approach to market two topics were selected to proceed into the pilot programme

3. note that the first pilot has reached agreement with APM Workcare Ltd (as service provider), subject to finance, to deliver a programme to assist into employment people diagnosed with a mental condition

4. note that the Social Bonds Pilot team in the Ministry of Health will report to the Ministers of Finance, Health and Social Development on whether the required finance has been successfully raised for the bond

5. agree that the Ministry of Social Development should administer this social bond pilot

6. agree to an outcome contract for a term of six years being entered into by the Chief Executive (or delegate) of the Ministry of Social Development with APM Workcare Ltd at subject to the successful raising of finance for the bond

7. agree to establish the following two new multi-year appropriations for the period 1 February 2017 to 30 June 2021:

<table>
<thead>
<tr>
<th>Vote</th>
<th>Appropriation Minister</th>
<th>Title</th>
<th>Type</th>
<th>Scope</th>
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</thead>
<tbody>
<tr>
<td>Social</td>
<td>Minister for Social Development</td>
<td>Mental Health and Employment Social Bond Pilot</td>
<td>Departmental Output Expense</td>
<td>This appropriation is limited to the outcome payments incurred under the Mental Health and Employment Social Bond Pilot.</td>
</tr>
<tr>
<td>Development</td>
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<tr>
<td>Social</td>
<td>Minister for Social Development</td>
<td>Administering Support for the Mental Health and Employment Social Bond Pilot</td>
<td>Departmental Output Expense</td>
<td>This appropriation is limited to the costs of administering and providing business support to the Mental Health and Employment Social Bond Pilot.</td>
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<tr>
<td>Development</td>
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8. note that a further two multi-year appropriations will be sought at a later date for the final two years of the six-year contract, using the unspent balance of the first two multi-year appropriations
9 agree to the following increases in appropriations with a corresponding impact on the operating balance:

<table>
<thead>
<tr>
<th>Vote Name</th>
<th>2016/17 to 2020/21</th>
<th>2021/22 &amp; Outyears</th>
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<tbody>
<tr>
<td>Departmental Output Expense: Mental Health and Employment Social Bond Pilot (funded by revenue Crown)</td>
<td>[3]</td>
<td></td>
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<tr>
<td>Departmental Output Expense: Administering Support for the Mental Health and Employment Social Bond Pilot (funded by revenue Crown)</td>
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10 direct the Ministry of Social Development to undertake two evaluations of the bonds contract, the first in 2020, the second in 2023, at a cost of up to [3] with the scope of these evaluations to be agreed between the Treasury and the Ministry of Social Development and the completed evaluations to be reported to the Ministers of Finance and Social Development.

11 note that the social bonds team in the Ministry of Health will report to the Ministers of Finance and Health on the results of the evaluation of the social bond pilot to date.

12 agree that the increases in appropriations in recommendation 9 above be met from the social bond pilots funding tagged contingency established as part of Budget 2015, and renewed in Budget 2016.

13 note that the indicative spending profile for the new multi-year appropriations described in recommendation 9 above is as follows:

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<td></td>
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<td>[3]</td>
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</tbody>
</table>

14 agree that the proposed change to appropriations for 2016/17 above be included in the 2016/17 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply.

Authorised for lodgement

Hon Bill English
Minister of Finance

Hon Anne Tolley
Minister for Social Development