Community Budgets Political Leadership Group
Innovative Finance - Initial Report

Executive summary

The Political Leadership Group identified the innovative use of finance as an important area for development in taking forward Community Budgets.

The present approach to finance by the public sector inhibits investment in proven and preventative interventions, leading to lower value for money than could be delivered by a more innovative approach.

Work around community budgets has identified several barriers to the use of finance to improve the cost-effectiveness of interventions for families and to reduce the future demand placed on and costs incurred by public services.

Key barriers include:

- **Multiple, uncoordinated funding streams at local level** – meaning less of an incentive for organisations to invest in cost-effective programmes because the subsequent financial savings accrue to a different part of the public sector.

- **Reactive approaches** – current professional practice and in some cases statutory requirements prioritise cases with the most serious current problems, rather than addressing emerging problems at an earlier stage when the costs would be lower.

- **Lack of understanding and use of the evidence base** – commissioners' knowledge of and expertise in using evidence on "what works" is limited so money is sometimes spent on less effective interventions, and not spent on the most effective.

- **Short term planning of public finances** – with Comprehensive Spending Review time horizons of only three years, and councils required to balance budgets in-year, less cost-effective short-term programmes are often preferred to those with longer-term benefits.

- **Commissioning activity rather than the delivery of outcomes** – so that providers are usually paid for undertaking certain activities, rather than delivering the intended social outcomes. Payment by Results and Social Impact Bonds are potentially useful tools to address this barrier.

- **Lack of effective structures** – for example Local Strategic Partnerships are not legal entities and there are no 'accountable officers' across local funding streams- so that partners do not feel able to pool funding, deliver joint work programmes, and re-invest joint savings generated together.

There is considerable potential to get more out of public services whilst delivering cost savings if these barriers can be successfully addressed.

The community budget pilot has not pooled any funding centrally at source in its first year. Whilst there is already some limited use of pooled budgeting at local level, particularly around health and social care, this is marginal with less than 4% of NHS and social care funding pooled.

Innovative financial approaches such as pooled budgets, payment by results and social impact bonds have the potential to deliver better outcomes and improved value for money, but to achieve this many key "pre requisites" need to be put in place which are missing at present.

The necessary elements include adopting a clear implementation model, developing the sector's capability to make robust use of evidence, a systematic approach to delivering cashable benefits, appropriate structural forms, and supporting development of an appropriate social investment market.

This paper summarises the existing barriers and proposes actions to start to address these and to deliver better value for money from future public investment in local areas.

Key Recommendations

While the barriers identified above are significant, the potential for major social and financial return on investment makes addressing these worthy of further exploration. There are a number of areas that urgently need to be taken forward to ensure the success of future implementations.

1. **Conduct trials of "Payment By Results" and "Social Impact Bonds" schemes for families with complex needs as part of community budget phase 1 pilots.** Whitehall and local authority representatives should co-design pilot schemes for the key outcomes in relation to families with complex needs (e.g. health, crime, worklessness, child protection and housing). Whitehall will need to commit to risk sharing in this trial as the implementation, political, financial and political risks are high. This should be coordinated with the current cabinet office work around SIBs.

2. **Develop Local Government's capability to make robust use of evidence** – in order to provide an attractive offer to potential investors, whether public or private, it will be necessary to further build up the research and evaluation capacity of the sector through a sector-led NICE type body to co-ordinate and share learning on "what works". This will both provide reassurance to investors that returns can be achieved, and help to focus resources on those activities likely to have the most significant impact.

3. **Support the development of tools to provide intelligence on the cost/benefits of evidence-based programmes.** This should build on the current investment of Birmingham, Manchester and GLA councils into the Washington State model's translation to the UK context, Manchester's work with HMT on value for money assessment and Westminster's assessment of cost avoidance.

4. **Develop a systematic approach to delivering cashable benefits** – in order to ensure that the anticipated financial savings from preventative interventions are effectively captured in practice. This should build on the methodologies developed by Birmingham and Manchester.

5. **Trial alternative structural forms to facilitate effective joint investment** – such as the Local Integrated Services Trust approach where delivery vehicles are jointly owned by local public sector partners.

6. **Agree an explicit implementation model for mainstreaming delivery of more effective, evidence based interventions and innovative finance**, taking into account the need for pump priming and the capabilities required to embed their use.

Community Budgets Political Leadership Group
Innovative Finance

Detailed Report

Background

The Leadership Group requested Birmingham and West London Councils develop proposals to address issues around innovative finance at their meeting on 5th April. This paper sets out the initial feedback from this work.

The need for innovative finance and funding

The HM Treasury report on the Total Place pilots in 2010 concluded[1] that:

- the public spending context is driving greater focus on delivering better services at less cost;

- 'resource mapping' has demonstrated **the complexity of funding streams**;

- a citizen viewpoint shows how **public services are often impersonal, fragmented and unnecessarily complex**;

- the system driving the **current arrangement of public services is overly complex**; and

- Individuals and **families with complex needs** impose significant costs on areas, but in most cases they **are currently not tackled through targeted or preventative activities.**

The public sector requires new approaches to finance and funding because:

- Public money is currently **not always invested in the most cost-effective interventions** with the greatest likelihood of improving key outcomes and reducing long term dependency and costs.

- The present "silo" approach to funding (where individual central government departments are funded for a specific set of services and interventions) creates the fragmented and complex approach at local level which **discourages investment in cost-effective prevention**. Local public bodies need adequate incentives to invest in change even where the benefits will accrue disproportionately to other organisations that are not making the investment.

- There is potential **benefit in transferring the "risk" around delivery** of effective interventions to the private sector to encourage more effective delivery.

- A **robust business case is required** to enable future savings in service delivery to be delivered through effective investment in preventative interventions. This will require much more intelligent use of available evidence, as well as generating new evidence in future.

[1] "Total Place: A whole area approach to public services", HM Treasury, March 2010

Virtual and actual pooling approaches

Pooled funds have helped some organisations to improve partnership working. **However, the arrangements can be complex**, leading to problems of governance and accountability. Some bodies have also been deterred by technical problems of implementation, although these can be less complex than they appear once fully understood.

It is difficult to show that pooled funds have directly achieved better value for money or have made a tangible difference for service users. Outcome measures are rarely quantified in partnership agreements or subsequently monitored. Nationally, there are weak relationships between individual factors and specific joint outputs or outcomes. The national and local focus has tended to be on process rather than outcome. Organisations point to intangible benefits such as better partnership working and improved mutual understanding.

The take up of pooled budgets is relatively small. Audit Commission research[2] in 2008 showed that, whilst a range of statutory powers are available, the actual take up of pooled funding arrangements outside learning disability, mental health and community equipment services is limited. Figure 1 (below) illustrates this limited range of pooled funding arrangements, and figure 2 shows the very small proportion of expenditure covered by such arrangements. This position is unlikely to have changed significantly in the following three years.

The Audit Commission found a range of mechanisms available (see Appendix 1) but also **there are several perceived barriers to pooling**. Local bodies have mixed views about the complexities and benefits of implementing the relevant legislation, for example around accounting requirements. Other examples of difficulties cited include risk-sharing and how to recover Value Added Tax (VAT).

Traditional arrangements to broker joint pooling have failed in many areas. The "infrastructure" of non-statutory Local Strategic Partnerships, Total Place and Community Budget pilots has not been sufficient to enable widespread take-up of pooled budgets.

An alternative of "aligning" funding has been adopted in many areas, although how far this has delivered significant change in practice has not yet been evaluated.

[2] "Clarifying Joint Financial Arrangements", Audit Commission, 2008

Figure 1: Range of pooled fund arrangements

The take up of pooled funding arrangements outside learning disability, mental health and community equipment services is limited.

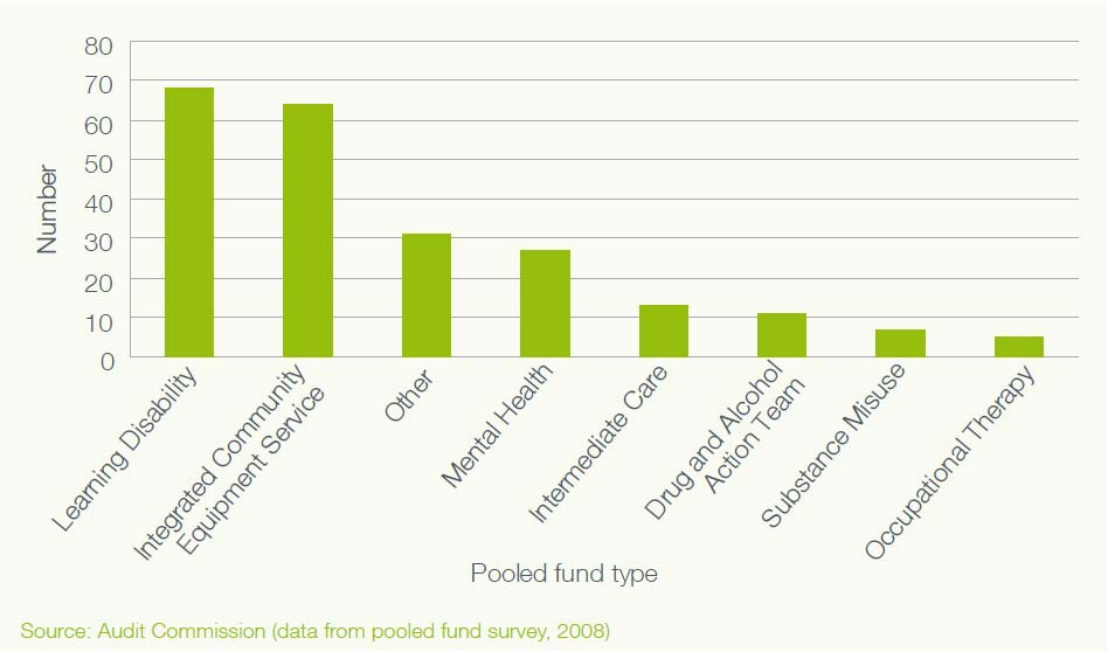
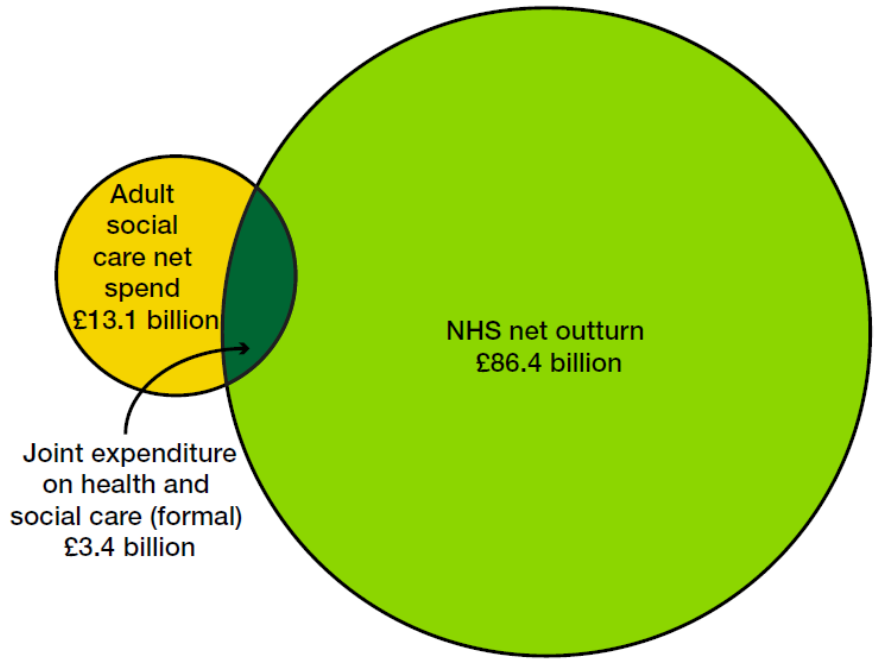


Figure 2: Formal joint health and social care expenditure

Formal joint health and social care expenditure amounts to only 3.4% of spending



Source: Audit Commission (data from DH Departmental Report 2009, PSSEX1 2007/08, DH notification register 2008, Audit Commission pooled fund survey 2008)

Payment by results

What is Payment by Results?

Put simply, Payment by Results (PBR) is a mechanism where a 'funder' or Commissioner only pays for delivery activity if that activity achieves the 'outcomes' that the funder wants it to achieve. The concept of payment-on-delivery after the end results have been achieved would seem a sensible, cost-effective proposition. Add an element of premium to reward success, or a non-payment penalty for failure, and to taxpayers, government departments and many rational-thinking organisations, PBR would seem the obvious contractual choice.

Such contractual mechanisms put incentives in place to drive the right activity within delivery organisations, with the objectives of driving efficiency and improving outcomes.

How are "Payment by Results" schemes paid for?

There are a number of types of PBR:

- Schemes that are aimed at changing behaviour and driving efficiency within providers, enabling the opening up of markets and improving contestability e.g. the DH tariff payments in the NHS. The payment can be based upon an activity or increasingly on a result where some risk is transferred to the supplier.
- Schemes that are aimed at delivering specific outcomes within target cohorts, not necessarily driven or funded by demand reductions e.g. the MOJ rehabilitation pilots with the voluntary/ private sector.
- Schemes that are paid for by the reductions in demand on public services that delivering the right outcomes achieves. These are 'invest to save' schemes with the investment in preventative activity paid for by future reductions in demand on public services e.g. MOJ Financial Incentive Model or Youth Justice Re-investment or DWP Work Programme.

See Appendix 2 for a summary of current PBR schemes.

What needs to be in place for a PBR scheme involving local authorities to work?

In order to feel comfortable with agreeing to a Payment by Results contract for dealing with problem families a local authority would have to:

- **Understand the exact nature of the outcome(s) they are trying to achieve**
    - Can they achieve the outcome by their own actions solely? E.g. can reducing teenage pregnancy or reducing Looked After Children (LAC) be the responsibility of a single agency?
    - Agree who 'owns' the outcome and will pay for the activity required to improve? If the LA 'own' the outcome they would be the 'commissioner' and pay for the results delivered by a provider. If Government owns the outcome- they could commission a local authority as a provider. E.g LAC would be the local authority's responsibility and crime would be that of MOJ/ Courts and Police.
    - Understand the cohort and what might influence their behaviour- i.e. in PBR paid for by demand reduction the whole population affected by the issue would have to be addressed e.g. all offenders in any scheme paid for by closing prisons/ courts. How far can the LA affect the whole population? Schemes aimed at particular cohorts are often preferable from the LA view-point but may be more difficult to pay for by demand reductions.

- **Understand what interventions they could carry out to change the outcome**
    - Does a validated body of evidence exist that links intervention with outcome improvement? In many areas good evidence does exist but it sometimes relates to specific small scale projects and generalisation can be an issue. Pulling together all the evidence from multiple sources is resource intensive but crucial to the levels of confidence and understanding of risk. The Allen Review on Early Interview drew a similar conclusion and identified the need for a local authority led capability to support commissioners in this area. Birmingham and partner councils' work with Washington State Institute will provide a strong starting point.
    - Can outcome improvements be costed? Are cost avoidance methodologies available? Can the local authority estimate how much of their costs can be avoided?

- **Be able and have the authority to provide or commission a service to deliver the outcome**
    - Are multiple agents involved and can a joint service or joint commission be devised?
    - Do statutory requirements limit the ability to use the most effective interventions or impose unnecessary burdens?
    - Are some areas of work politically sensitive meaning that outsourced providers are not going to be acceptable? e.g Members and officers may wish to keep in-house some core Statutory high risk child protection.

- **Believe that they can achieve cashable savings either for themselves or for the commissioner**
    - Does improving the outcome result in a reduction in demand on the system?
    - Can a demand reduction translate into a cashable efficiency?
    - Can the LA and partners achieve the scale of demand reduction to enable cashable efficiencies?
    - Can a strategy of cashing efficiencies be devised?
    - Are local public sector internal finance systems flexible enough to cope?
    - How do you prevent cashable savings being soaked up by demand increase?

- **Have the capital available to invest upfront**
    - As schemes tend to pay on results with little upfront investment, the LA need to be able to access funds for upfront investment.
    - SIBs are a mechanisms to draw on alternative finance but the rates of return and reliance on cashable efficiencies materialising makes this risky.

- **Be prepared and able to take risks, and have the finances available in the event of failure**
    - The LA would need to be able to fund interventions in the understanding that if they do not achieve the results, there will be no payment.

Two key issues for local authorities taking on PBR contracts relate to the choice of provider and the ownership of risks.

Who can be a provider?

Any organisation- private, third sector or public -could theoretically become a provider, the crucial factor is that those paying for the outcome (Commissioner) and those carrying out the interventions and providing the service (Provider) have to be distinct.

Where Government holds the funds that pays for the consequences of a particular outcome e.g. worklessness, it will be the Commissioner of back-to-work services, and theoretically providers could come from any sector.

Where the LA is the Commissioner e.g. in respect of some of the outcomes in relation to families with complex needs (LAC, child protection etc), then they will become a Commissioner. The independent provider of services will have to be distinct from the Commissioner. This may pose some issues for some local authorities with high performing in-sourced provision.

To be a provider (and to some extent Commissioner) an organisation must be able to take risks, have sufficient capital to ride those risks and have experience in the market. Smaller organisations might achieve this through collaborative arrangements.

Where do the risks fall?

In PBR schemes it is theoretically possible to transfer all risk to the provider from the Commissioner. There are a number of reasons why it would not be advisable for families with complex problems:

- The schemes are in their infancy and the more complex and innovative schemes such as SIBs carry high inherent delivery risks due to their novel nature and lack of experience. A degree of risk sharing between Commissioners and Providers will be necessary to pump prime.
- Small voluntary providers and most of the public sector do not have reserves available to 'experiment', fund upfront investment, and ride the risks of failure.
- The complexity of families with complex needs requires multiple agent involvement on the ground and cross Whitehall commitment. It would be classed by KPMG[3] as the most complex, underdeveloped and 'bleeding edge' policy. KPMG suggest such approaches need a 'managed programme of experiments to push this forward' exploring how to manage the complex risks and rewards and the boundaries of cross-government and multi-year spending'.

Figure 3: Barriers to implementation of PBR for families with complex needs and possible solutions

Barrier	Solutions
Commissioner/ Provider split Many Local Authorities are not culturally, managerially or politically at the maturity to deal with a Commissioner/ Provider split, with LA as Commissioner.	Not easy to solve... If the innovative finance and the benefits to LA are seen across the sector then these challenges will be tackled. At this stage in development the Government should work with the LAs able to work with a Commissioner/ Provider split.
Accountability and private/ social providers Issues around families with complex needs often involve statutory services, and cost effective services tend to be single 'team around the family' type solutions. These are core not additional services, and as such there may be disquiet about outsourcing to private/ third sector providers.	The DFE and local government family should work together to clarify this area to deal with concerns.

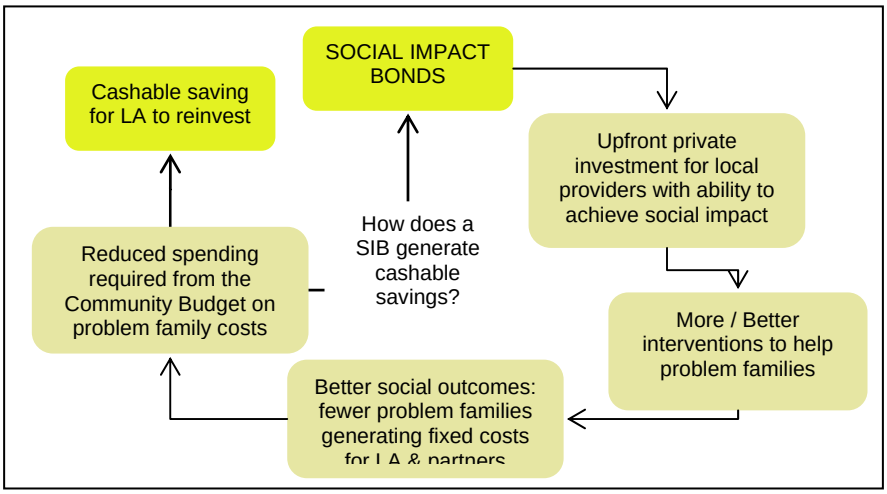
[3]KPMG, 2010, Payment for Success

Barrier	Solutions
Costs avoided to cashable efficiencies Existing data on cashable efficiencies in this area are of mixed levels of robustness, and could hamper any initiatives in this area.	Government and local government family should work together to produce more robust evidence on cashable efficiencies. For example, Birmingham has completed a significant randomised controlled trial in this area and is working with Washington State Institute and two UK councils to translate their econometric model to the UK context. This could be expanded through the early SIB pilots and is essential to move the policy on.
Public sector and dealing with risk. Local authorities and small providers will tend to have a cautious approach to risk, and PBR schemes will be novel, unknown and associated with difficult to quantify risks.	The Government will have to commit to sharing the risk in early stages to this policy development.
Complex problems, multiple outcomes and multiple stakeholders	Clear outcome accountability - who is responsible for commissioning outcomes for child protection, criminal justice , worklessness, poor health Engagement and commitment of all players round the table including Whitehall departments to designing a PBR approach.
Ownership and determination on outcomes to be delivered- at the moment local areas have little ability to determine the outcomes and cohorts	Government need to extend the directly commissioned models of PBR (rather than general demand reduction models) to outcomes vital for families with complex needs There needs to be a negotiation on outcomes between Whitehall and places rather than Whitehall specifying and LA trying to 'fit' into a particular national model
Demand – reduction based PBR schemes don't fit families with complex needs	Specific schemes should be developed for this cohort or Whitehall should commit to a PBR 'pot' for families with complex needs
Payment in PBR will be based on high level outcome (eg work) which are difficult to achieve quickly in the most difficult families	For families with complex needs we need to determine intermediate outputs e.g. indications of steps towards work
Financing interventions- capital required	Capital funded through: SIBs pilots/ experiments with Government/ LA risk sharing arrangement Draw down on Early Intervention Grant for those outcomes solely the responsibility of local authorities (eg child protection/ LAC)
Achieving scale: each LA will have relatively small numbers	LA may need to join as consortia and pilots should include the larger councils.
Lack of easily accessible evidence base on what works and how much it costs on which to make decisions –and lack of skills and competency to make use of the available evidence.	Government and local government family should bring together the available evidence, not just in existing silo based approaches (e.g. one for children's outcomes, one for offending) but a coherent and joined up view across outcomes. Some first phase CB pilot councils are well placed to take forward this approach.

Social impact bonds

Social Impact Bonds (SIBs) are designed to attract private investors to fund public service programmes (interventions). Under SIBs, commissioners (eg local authorities) pay investors, not providers, only as and when specified outcomes are delivered. These outcomes will reduce demand for higher cost interventions, such as children needing residential care.

Figure 4: How SIBs could help generate cashable savings



Source: Cabinet Office (draft)

To attract investors, **there needs to be robust evidence that the interventions will achieve savings through the specified outcomes**. There also needs to be clarity on how the outcomes will be assessed and measured (including which specific population sub-groups are involved).

The "fidelity" of the implementation of the interventions (ie sticking to the approach tested in the evidence base) is key to ensuring anticipated benefits are delivered in practice. In the USA, specific social enterprises have been created to deliver evidence-based programmes at a given price.

Many of the outcomes in SIBs will impact and be impacted upon by the activities of various agencies. There is a strong case for relevant agencies to be joint commissioners of the approach.

Examples of interventions which commissioners might wish to invest in could include the following (along with illustrative areas where potential savings in future public expenditure could be realised):

- Family Nurse Partnerships – which show strong evidence of improvements around conduct disorders, reductions in teenage pregnancies, reductions in crime and anti-social behaviours, and improved mental health for parents.

- Functional Family Therapy – which can evidence reductions in child abuse and non accidental injuries, reduced hyperactive behaviour and conduct problems, reductions in domestic violence, in crime and anti-social behaviour.

- Incredible Years – a parenting programme which can evidence reductions in A&E attendance, reductions in domestic violence, increased participation in education, employment and training.

Examples of existing work around social impact bonds include:

- The Ministry of Justice has the first SiB scheme at Peterborough Prison based on reducing re-offending rates for 3,000 ex offenders. This £5m bond was established in 2009 with social equity firm Social Finance with a seven year time frame.

- Birmingham is working with the Graham Allen review and Cabinet Office to investigate options for a social investment bond around early intervention. This differs significantly from the MoJ example because the existence of a particularly robust evidence base may suggest more direction for the commissioner (along the lines of the Work Programme) via supply chain managers, and may make it particularly attractive to commercial investors.

- Manchester, Liverpool and Essex councils are working with Social Finance to create a social impact bond to fund services for vulnerable children, young people and their families. The desired outcome is to reduce the number of 10-15 year olds going into care.

- Birmingham is working with Social Finance and Cadburys Charitable Trust to investigate a potential SIB around physical activity to prevent ill health.

There are several important barriers, both for commissioners, investors and providers, which need to be addressed in any SIB proposal:

- **For commissioners** these include **the risk of perverse incentives**, **statutory responsibilities, ensuring value for money, cashable benefits realisation, clarity on outcomes and the verification of their link to agreed funded activities.**

- Where there are multiple commissioners and beneficiaries, as is the case for families with complex needs, **there needs to be a mechanism to get agreement at local and national level on the payment criteria.** This would be much easier if Whitehall could find a way of pooling their funding at a local level (eg a single payment to each geographic area).

- **For investors issues include political risk** (in dealing with the public sector), raising capital, contingent liabilities, taxation of returns, **measuring outcomes**, and the time lag before returns are paid.

- **For providers issues include risk management**, capacity levels to deliver significantly higher activity, and the use of outcomes-based contracting.

Social Finance has concluded that SIBs are feasible where:

- They address a social problem that has high costs for the public sector and can be measured;

- The costs are such that, if avoided, they will reduce the public sector's expenditure;

- It is possible to identify the individuals that could benefit from the services funded by Social Impact Bond investment;

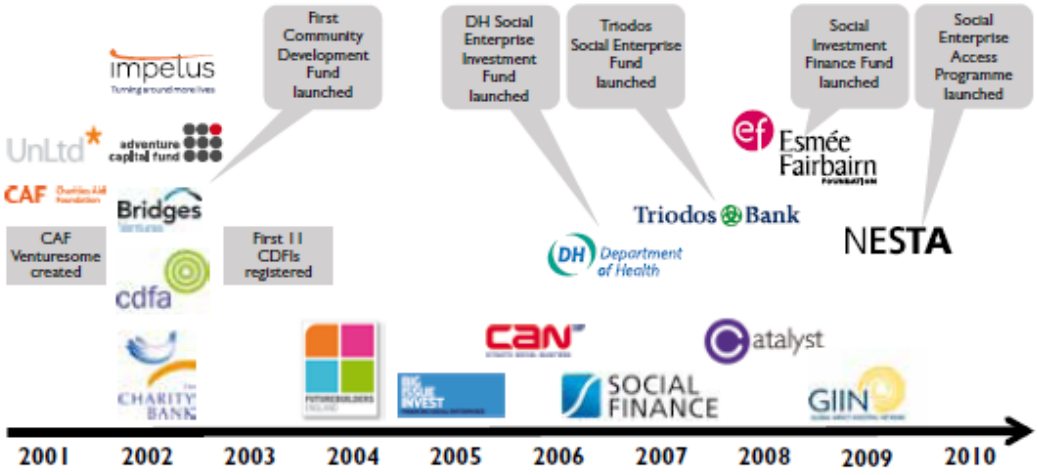
- Interventions that would deliver improved social outcomes are known; and

- The interventions cost substantially less than the public sector savings that would result from improved social outcomes.

The Social Finance Market

There is an emerging market for social finance for social ventures. The Government has recently set out its commitment[4] to accelerate the growth of this market.

Figure 5: Time line for development of social investment market
The social investment market has grown from almost nothing over the past 10 years, and in 2010 made nearly £200 million of social investments.



Source: Cabinet Office

The market size remains relatively small at £190m, compared to the approximate annual philanthropic grant giving of £3,600m, individual giving of £13,100m and wider bank lending of £55,300m.

Examples of potential investors include:
- Charities and foundations
- Individual (retail) investors and "high net worth individuals"
- Corporate institutions (eg corporate social responsibility programmes)
- Financial institutions (a range of products such as Ethical ISAs and Bonds)
- The Big Society Bank (a new wholesale investor to social finance intermediaries)
- Public sector
- European Investment Bank
- Community Development Finance Institutions (where investors in social enterprises and community projects benefit from tax relief opportunities)

[4] "Growing the social investment market", Cabinet Office, 2011

Recommendations around Payment-by-Results and Social Impact Bonds

The following recommendations relate to the development of PBR and SIB schemes:

1. **Conduct trials of "Payment By Results" and "Social Impact Bonds" schemes for families with complex needs as part of community budget phase 1 pilots.** Whitehall and local authority representatives should co-design pilot schemes for the key outcomes in relation to families with complex needs (e.g. health, crime, worklessness, child protection and housing). Whitehall will need to commit to risk sharing in this trial as the implementation, political, financial and political risks are high. This should be coordinated with the current cabinet office work around SIBs.

2. **Shared outcomes** – In designing a finance model, it is important to determine what outcome you are looking for in the first instance, and then develop the right contracting model to achieve it. Involving service providers and beneficiaries in the process for defining outcomes would be a significant step forward in ensuring outcomes can work for all stakeholders.

3. **Flexible delivery/ownership** – to ensure all relevant stakeholders are incentivised to achieve outcomes, allow a more flexible approach to delivery that enables all who can impact to benefit from results. Additionally, some stakeholders may require certain freedoms and flexibilities from existing delivery mechanisms in order to contribute rather than possibly having competing objectives e.g. between police and local authority in reducing demand on the criminal justice system.

4. **Develop Local Government's capability to make robust use of evidence** – in order to provide an attractive offer to potential investors, whether public or private, it will be necessary to further build up the research and evaluation capacity of the sector through a sector-led NICE type body to co-ordinate and share learning on "what works". This will both provide reassurance to investors that returns can be achieved, and help to focus resources on those activities likely to have the most significant impact.

Necessary pre-conditions for innovative finance to work

Pooled funding and joint commissioning has not yet been widely successfully adopted because of the lack of certain key pre-requisites.

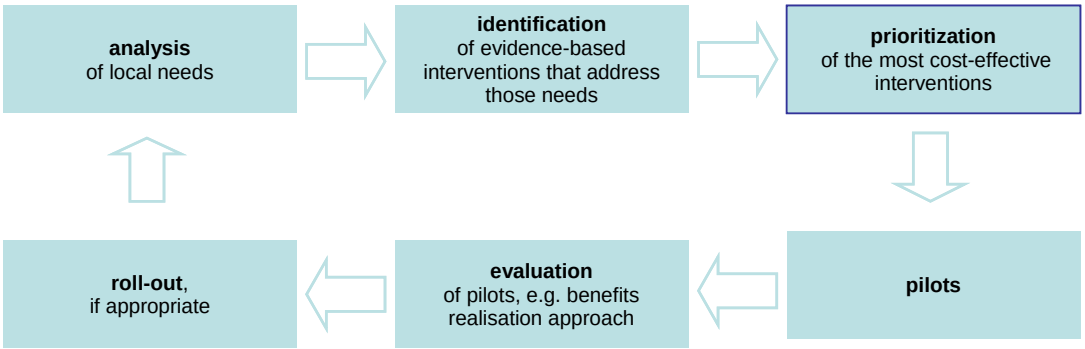
These include the need for:

- a consistent implementation model
- robust evidence on effectiveness with clear cost/benefit analysis and effective evaluation
- systematic benefits realisation (ie delivering the anticipated savings)
- structural forms to enable integrated funding and delivery of public services locally
- the ability to pump prime preventative programmes
- embedding the use of innovative financing models

Implementation Model

The National Audit Office is developing an implementation model for more effective, evidence-based public service interventions. An early draft is below.

Figure 6: Implementation model



Robust Use of Evidence

Experience in other countries, particularly the US, can provide helpful pointers for the UK in developing the necessary approach to using evidence.

The Washington State Institute for Public Policy (WSIPP) makes recommendations to the Washington State Legislature on which programmes they should fund, based on high-quality evidence. The Institute has been synthesising information on evidence-based interventions for fifteen years. Portfolios of investment are a recent development.

A portfolio of investment is a type of analysis that says how a combination of policy options could affect outcomes of interest, for example, re-offending rates. The analysis also measures the risk attached to the investment, by altering some of the assumptions.

Washington State has improved its youth justice system in the last fifteen years by

- developing consistent assessment tools;
- ensuring the highest possible fidelity; and
- implementing a funding formula that is backed up by portfolios of investment.

The Washington State Legislature gives flexibility to courts to put together the combination of evidence-based interventions that best address their local needs. However, all of the interventions must have been proved cost-effective by the Institute, in the context of their portfolios of investment.

The local government sector needs a shared capability to deliver intelligence on the evidence base, and consistent assessment tools. This is likely to be supported by the forthcoming Graham Allen review of early intervention commissioned by the Government. This would be analogous to the role played by National Institute for Health and Clinical Excellence around drug treatments in the NHS. Birmingham has offered to host this capability in collaboration with the LG Group.

Birmingham, Manchester and the GLA **councils are currently working with WSIPP to "translate" this model into a tool for use in the UK context**. These are the main characteristics of the tool:

- all the interventions in it will be evidence based;
- the evidence will refer to the UK to the largest possible extent;
- users will be able to input local data, e.g. re-offending rates;
- there will be an option to develop portfolios of investment with different estimates of avoided costs;
- the portfolios will be adjusted by the risk of not achieving the expected outcomes.

There are existing frameworks around assessing costs and benefits in this area which could usefully be consolidated into a flexible sector approach:

- Manchester City Council has worked with HM Treasury to develop an application of the "Green Book" approach to the assessment of value for money to preventative programmes.
- Westminster City Council has developed a structured approach to assessing cost avoidance through its family intervention programme.
- Birmingham City Council has developed its approach to cost benefit analysis and benefits realisation in partnership with the Dartington Social Research Unit and WSIPP. The council is mid-way through a two year randomised controlled trial of four key evidence-based interventions for children and families.

The effective use of evaluation in the community budgets pilots and more widely will be critical to the development of a robust evidence base for preventative interventions. A CLG-led working group has been established in the CB pilots to agree common principles here.

DfE is currently working with Birmingham, Bradford, Leicestershire and Manchester councils to develop an "exemplar project" on evaluation, cost-benefit analysis and information sharing. It is of concern that the funding for these projects is currently proposed at significantly less than the originally anticipated level which could mean the key intended outputs are not able to be delivered as intended – discussions about final arrangements are ongoing.

<u>Systematic Benefits Realisation</u>

Given the continuing need to reduce public expenditure in the medium term, **it is essential that investments in preventative programmes actually lead to reductions in future expenditure**. In other words, that the anticipated financial benefits are "realised".

For commissioners to be able to generate cashable savings the following are important considerations:

- The savings generated need to be part of a budget controlled by the commissioner (emphasising the need for robust pooled budgets and appropriate structural forms)

- Costs respond to the decline in demand (ie it is possible to reduce costs, so staffing a social care team is easier to control than the asset costs of a recently built prison building).

- Potential additional demand that would replace reduced demand attributable to the intervention is managed effectively.

Birmingham City Council is implementing an approach that builds on these principles of portfolios of investment through its £40m "Brighter Futures" programme which is expected to **avoid £250m of costs across all agencies** in the city in the next fifteen years. Birmingham City Council and Capita have developed an approach to business transformation which includes specific systematic methods of ensuring benefits realisation. The CHAMPS2 methodology[5] is available as an open source approach to the public sector.

Greater Manchester councils are analysing the marginal return on investment in evidence-based programmes in comparison with current practice, to support planning future mainstream spending.

Structural forms

Local public bodies need adequate incentives to invest in change even where the benefits will accrue disproportionately to other organisations that are not making the investment.

Whilst there are many options for joint financing and integration (see section on "virtual and actual pooling" above), their success so far in delivering pooled budgets and commissioning has been limited.

One model worth investigating further may be the Local Integrated Services Trust (LIST) proposed by lawyers Bevan Brittan[6]. In this model a social enterprise - the body called LIST - would be owned by as many local public bodies as possible to ease the position of procuring services from it.

The role of this LIST would be to:

- Identify projects where investment in service change would provide an overall benefit in reducing waste or cost or making quality improvements for users.

- Broker the change, transferring the risk of delivery away from individual organisations, pooling the opportunities and benefits, supported by social investment funds where appropriate.

- In its brokerage role, the LIST would be principally a facilitator, extending to supply chain manager, but it could also assume a role as part commissioner and that commissioning role could expand over time, building on past successes with the encouragement and support of its member organisations.

- Profits over time can be re-invested in projects that meet local priorities, some of which may have higher risks or longer term payback.

[5] See http://www.champs2.info/
[6] "Local Integrated Services Trusts", Bevan Brittan, 2010

Pump Priming Preventative Programmes

Community Budgets pilots, by nature of their focus on families with complex needs and the involvement of multiple agencies, are likely to involve the shifting of resources away from reactive services towards proactive, early intervention programmes. Returns from investments in early intervention programmes are not always realised immediately. This is because:

- it takes time to address dependency and reduce the cost burden on the state – e.g. moving the long-term unemployed closer to the labour market is a slow process;
- some outcomes will result in an improvement in the long-term life chances of an individual but will not deliver short-term cost savings - e.g. improved school attendance and educational attainment;
- reactive spend savings are often spread over a long timescale and may not, in year 1, cover the cost of the intervention – e.g. preventing a child entering care will be costly, but will deliver reactive cost savings in Year 1, and then in subsequent years.

Pump-priming funds can provide a solution to these challenges by reducing the pressure on service deliverers quickly to decommission existing provision in order to pay for new provision. Pump-priming, through innovations such as social impact bonds and payment by results models, allows new interventions to be established and sustained, with the longer-term savings from the interventions being used to pay back the initial investment.

Embedding the use of innovative financing models

Before a pilot area decides to adopt an innovative financing model it will need to consider whether it has the necessary expertise, capacity and governance structures in place. For example:

- Pilots need the technical skills and capacity to be able to:
    - Firstly, forecast what future savings they feel they can sign-up to deliver based on upfront/novel investment models;
    - Secondly, track progress towards, and achievement of, these future cost savings such that future repayment requirements can be met.
- Pilots need to agree how interventions funded by innovative financial mechanisms will relate to interventions funded by mainstream funding. There is a real risk that if families have access to both types of intervention it will be impossible to prove unequivocally which intervention led to which outcome, and hence what level of repayment should be made on the initial financial agreement
- Pilots need to establish adequate governance structures, so that a group of agencies can commit to a common way of working, funded in a common way, and accepting of the fact risks relating to future repayments fall upon that agency.
- Pilots need to forge relationships with institutions they are unlikely to deal with on a day-to-day basis – e.g. philanthropic societies, pension funds, hedge funds etc. Partners such as the Cabinet Office and Social Finance can broker these relationships.
- An independent monitoring body/arbitrator may need to be established to mediate between the pilot agencies and investors

Recommendations around necessary pre-conditions

Recommendations around creating the necessary pre-conditions for effective use of innovative finance are:

5. **Support the development of tools to provide intelligence on the cost/benefits of evidence-based programmes.** This should build on the current investment of Birmingham, Manchester and GLA councils into the Washington State model's translation to the UK context, Manchester's work with HMT on value for money assessment and Westminster's assessment of cost avoidance.

6. **Develop a systematic approach to delivering cashable benefits** – in order to ensure that the anticipated financial savings from preventative interventions are effectively captured in practice. This should build on the methodologies developed by Birmingham and Manchester.

7. **Trial alternative structural forms to facilitate effective joint investment** – such as the Local Integrated Services Trust approach where delivery vehicles are jointly owned by local public sector partners.

8. **Agree an explicit implementation model for mainstreaming delivery of more effective, evidence based interventions and innovative finance**, taking into account the need for pump priming and the capabilities required to embed their use.

Appendix 1
Examples of options for joint financing and integration

The following options were identified by the Audit Commission[7] in 2009.

Arrangement	Description	Legislative basis: NHS Act 2006	Further detail
Lead commissioning	One partner takes the lead (and acts as the host) in commissioning services on behalf of another to achieve a jointly agreed set of aims.	Section 75	Suitable option depending on size and make-up of the service to be commissioned.
Integrated management or provision	One partner delegates their duties to another to jointly manage service provision; or partners combine (pool) resources, staff and management structures to help integrate provision of a service from managerial level to the frontline. One partner acts as the host to undertake the other's functions.	Section 75	Helps to ensure cooperation and prevent duplication where the same person is responsible for services for both bodies.
Pooled funds	Each partner makes contributions to a common fund to be spent on pooled functions or agreed NHS or health-related council services under the management of a host partner organisation.	Section 75	Shared resources and responsibility to meet specific local needs is acknowledged. Flexibility, as expenditure and service response is based on users' needs rather than financial contributions, helping to prevent disputes over funding responsibilities. Essential where a service is, or moving towards being, fully integrated. Associated processes, e.g. financial management and technical requirement of the pool seen to be bureaucratic.
Combination of Section 75 flexibilities	Combination of any or all of the above, for example, pooled funds with lead commissioning arrangements, pooled fund with integrated provision or delegated (or lead) funds with pooled funds.	Section 75	Allows flexibility and seamless provision of care.

[7] "Means to an end", Audit Commission, October 2009

Arrangement	Description	Legislative basis: NHS Act 2006	Further detail
Aligned budgets	Partners align resources (identifying their own contributions) to meet ageed aims for a particular service, with jointly monitored spending and performance but separate management of, and accountability for, NHS and council funding streams.	Non-statutory	Flexibility around the use and monitoring of funds. Retained ownership of funds and responsibility of budget management. Interim step to pooling. Not ideal where a service is already integrated.
Aligned budgets with Section 75 flexibilities	One partner takes the lead in the management of jointly commissioned or provided services, but NHS and council funds are not pooled.	Section 75	Flexibility around the use and monitoring of funds against a jointly agreed set of aims. Retention of specialist knowledge by lead partner about specific service areas.
Care trusts	NHS and council health-related responsibilities are combined (via council delegation) within an NHS body under a single management. Can be formed from an existing NHS trust or PCT (in the latter case, the PCT is both a commissioner and provider).	Section 77 Section 75	Joint planning, commissioning and delivery of health and social care services across a local area.
PCT grants to councils	PCTs make transfer payments (service revenue or capital contributions) to councils to support or enhance a particular council service. This is not a partnership and there is no delegation or pooling or functions.	Section 256	Can be used to provide funding from one partner to another in order to offer a more effective use of resources and provide a greater level of care where necessary
Council grants to PCTs	As above, but for council transfers to PCTs.	Section 76	

Appendix 2: Current and planned PBR schemes

Scheme	Owner	Objective	Outcome(s)	CB Relevant	Type	LA	Complex Delivery	Payment
Youth Justice Reinvestment	Ministry of Justice	Reduce the Use of Youth Custody	Reduction in the number of custody bed nights in an area	Yes	Demand Reduction	Yes	No	Up front investment based on a proportion of anticipated savings; claw back if savings targets aren't fully achieved
Financial Incentive Model	Ministry of Justice	Reduce overall demand on the Criminal Justice System	Five proposed metrics including court cases, and custodial sentences	No	Demand Reduction	Yes	Yes	No upfront investment; Reward payment based on savings resulting from reductions in demand
Payment by Results – Health	Department of Health	Improve productivity	-	No	Direct Payment	No	No	Health Trusts are paid according to what they deliver not what they spend. Tariffs are set nationally to reflect efficient practice

Scheme	Owner	Objective	Outcome(s)	CB Relevant	Type	LA	Complex Delivery	Payment
Payment by Results – Work Programme	Department for Work and Pensions	Getting people into work	People entering sustained employment for a specified number of weeks	Yes	Direct Payment	No	Yes	Service providers are paid based on their success in getting people into work. Different tariffs are set commensurate with the perceived difficulty in getting a person into work. Higher premium for different clients.
Payment by Results – Drugs	Department of Health	Improve drug treatment	Improved drug treatment outcomes	Yes	Demand Reduction	Yes	No	Tariff
Payment by Results – Mental Health	Department of Health			Yes	Direct Payment	No	No	
Social Impact Fund	Cabinet Office	Addressing Problem Families	TBD	Yes	Demand Reduction	Yes	Yes	Philanthropic, Commercial and Government provide investment funds to achieve improved outcomes for problem families thereby reducing impact on Government budgets which are used to repay the investment

Scheme	Owner	Objective	Outcome(s)	CB Relevant	Type	LA	Complex Delivery	Payment
Social Impact Bond – Peterborough	Ministry of Justice	Reducing reoffending	Reduced reoffending rates of a cohort of 3,000 people on sentences less than 12-months	Yes		No	Yes	
Social Impact Bond – Children's Services	Department of Education	Reduce Children in Care	reduce numbers of vulnerable 10- to 15-year-olds going into care					TBD