

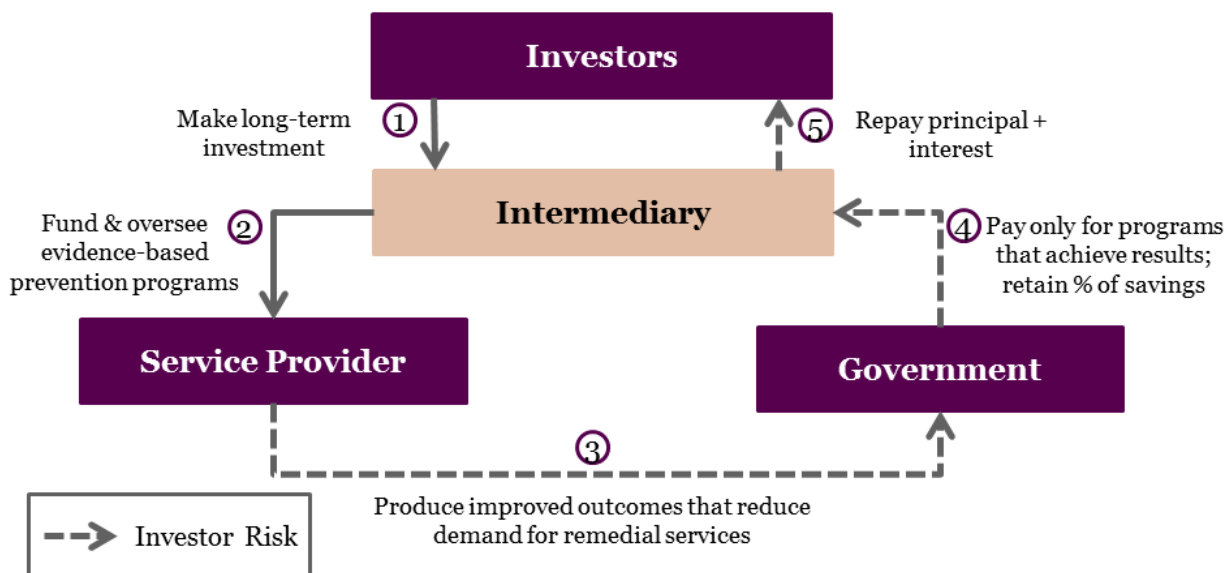


An Overview of Social Impact Bonds in the United States

What is a Social Impact Bond (SIB)?

A new financing structure that raises private dollars to fund effective social services, with government dollars spent only when social service providers achieve a certain level of performance. If the provider does not achieve the intended outcome, the government does not pay. SIBs are intended to diversify government funding of social services from reactionary, “emergency” investments only to prevention-oriented, low-risk investments.

How does a SIB work?¹



In the SIB model, government contracts with a private sector financing intermediary to obtain social services. This partnership stipulates the conditions under which the government will pay the intermediary given the achievement of performance targets. The intermediary, who also oversees the project, secures funding from investors and selects nonprofit organizations (service providers) that will carry out project services. The government pays the intermediary upon target outcomes being met. If the service provider fails to achieve the targets, the government does not pay. In some cases, government payments may be calculated as a function of government cost-savings attributable to the program’s success. If successful, the intermediary then returns principal plus interest to investors.²

¹ Graphic adapted from Social Finance US

² Jeffrey B. Liebman, “Social Impact Bonds: A Promising New Financing Model to Accelerate Social Innovation and Improve Government Performance.” *Center for American Progress*, February 2011. Online at http://www.americanprogress.org/issues/2011/02/pdf/social_impact_bonds.pdf

Where did they come from?

SIBs were created by Social Finance, a UK-based organization. The UK is currently testing the first SIB model in an effort to reduce prisoner recidivism in Petersborough, England. The UK has contracted with an intermediary to provide services to prisoners, and the government will only pay if recidivism is reduced by 7.5 percent relative to a comparison group of similar prisoners.³ Results will be available in 2014, though anecdotal reports thus far are positive. The Ministry of Justice published a report a year into the partnership to highlight lessons learned for future SIBs:

- The director overseeing the reduction of reoffending (employed by intermediary) is critical in coordinating SIB efforts
- Intermediaries should possess a broad range of skills and knowledge including negotiations, financial products, policy and relational skills
- Identifying constituent needs and characteristics and adapting intervention as necessary is critical⁴

What is currently happening in the US?

President Obama's proposal to appropriate \$100 million of the 2012 federal budget for SIB pilot testing in workforce development, education, juvenile justice and care of children with disabilities was rejected by Congress. Since then, his office has launched Pay-for-Success (PFS) pilots in criminal justice and workforce development (\$20 million) through the Departments of Justice and Labor, respectively. Deadlines for these contracts were April/May 2012, but awardees have not been announced. President Obama's proposed 2013 budget includes up to \$109 million to test PFS in a broader range of program areas, including homelessness.⁵

Across the country, states and municipalities have been actively considering the use of SIB to fund programs amidst budget shortfalls. Massachusetts and Minnesota have been the first states to take concrete steps toward piloting social impact bonds:

- In 2011, the Minnesota Pay for Performance Act established a pilot program that authorized \$10 million in bonds for this project. The Oversight Committee met in March 2012 to discuss which services should be included in the pilot program, standards for performance measurement, and evaluation.⁶
- Massachusetts Housing and Shelter Alliance and Roca Inc. have been selected to lead chronic homelessness and recidivism PFS projects, respectively, in the state. Third Sector Capital Partners was selected by the state to serve as the lead intermediary for these projects.⁷

³ Ibid., p. 2.

⁴ Ministry of Justice; Lessons Learned from the Planning and Early Implementation of the Social Impact Bond at HMP Peterborough; May 2011; Online: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/moj-research/social-impact-bond-hmp-peterborough.pdf>

⁵ McKinsey & Company; From Potential to Action: Bringing Social Impact Bonds to the US

⁶ Invest in Outcomes; Legislative Update; Online: http://investinoutcomes.org/?page_id=10

⁷ Third Sector Capital Partners; Mass. Program ties Nonprofits' Pay to Success; Online: <http://www.thirdsectorcap.org/blog/2012/08/01/boston-globe-ma-pay-for-success/>

- Goldman Sachs announced that it would invest \$9.6 million in a New York City juvenile justice program that aims to reduce reoffending after release. The firm will receive its entire investment back if recidivism declines by 10 percent; it also stands to profit as much as \$2.1 million if rates decline further. Unlike standard social impact bonds, however, \$7.2 million of Goldman's investment is guaranteed by New York City Mayor Michael Bloomberg's private foundation.⁸

What are the risks and challenges?⁹

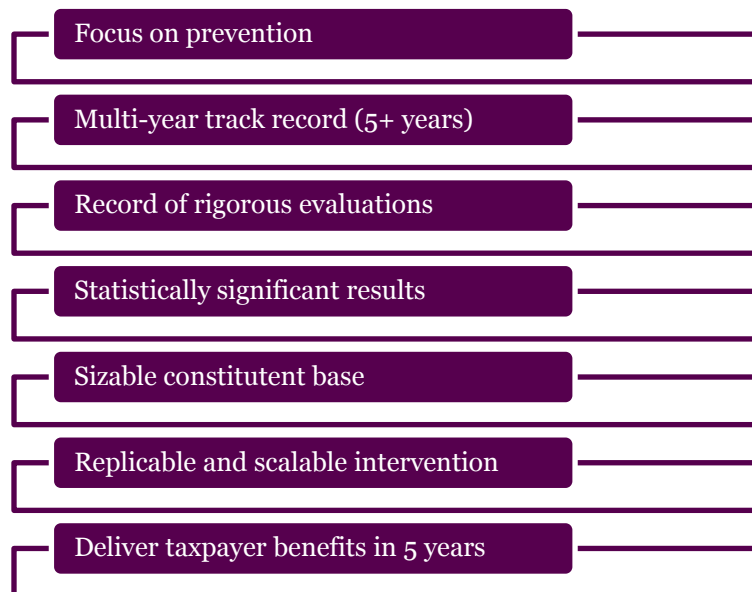
- Requires coordination between multiple players and strict adherence to multiple criteria in order to work
- Not all social problems will be a good fit due to measurement challenges and the difficulty of defining outcomes
- The time horizon for social change is often longer than government funding cycles; appropriations laws would need to be changed
- Lack of existing infrastructure, especially intermediary organizations and third-party evaluators
- Social services would need to place a greater emphasis on outcome measurement
- Could create unintended consequences in cases where social interventions were not effective

Should our nonprofit organization become a service provider?

- Nonprofit organizations or interventions failing to meet the criteria below should not consider the infusion of SIB capital to scale programs. As the model is tested and refined, the scope of eligible candidates may widen, but at this time, evidence-based, proven interventions overseen by high capacity nonprofit organizations are required to ensure the best possibility of success.
- Interventions meeting the following criteria may qualify for participation in a SIB to scale:

⁸ Associated Press; "Goldman Sachs to invest \$9.6M in NYC jail program as city tests social impact bonds"; August 2012

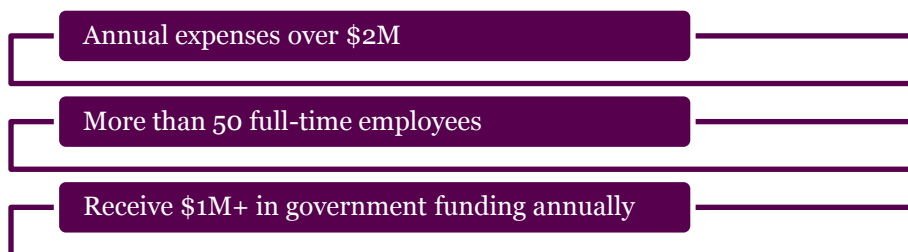
⁹ Liebman, "Social Impact Bonds," p. 15-17.



- Unlike traditional grants, SIB intermediaries will select partnering nonprofit organizations for this arrangement. Two likely intermediary candidates in the US are Social Finance US and the Nonprofit Finance Fund. Both organizations have published reports on SIB deployment in the US and recommend interventions in the following program areas for pilot testing¹⁰:

Program Area	Intervention
Chronic Homelessness	Permanent Supportive Housing
Juvenile Justice	Functional Family Therapy
Low-Income Seniors	Not Specified

- SIB service providers should have the following organizational characteristics in order to be an attractive partner to the intermediary. These characteristics are baseline indicators of the organization’s capacity to scale:



Much of the risk for nonprofit service providers is reputational. In the event the nonprofit organization is unable to deliver stated intervention results, it is likely to face highly publicized attention as the anticipation around SIBs continues to grow. Some of this risk can be mitigated through open communication with SIB partners throughout the life of the project. Those

¹⁰ Social Finance; Social Impact Bonds: An Overview; Online: <http://www.socialfinanceus.org/sites/socialfinanceus.org/files/small.SocialFinanceWPSingleFINAL.pdf>

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meeting the criteria above and who are able and willing to operate with the risk of public failure may want to conduct due diligence to see if SIB capital can work.