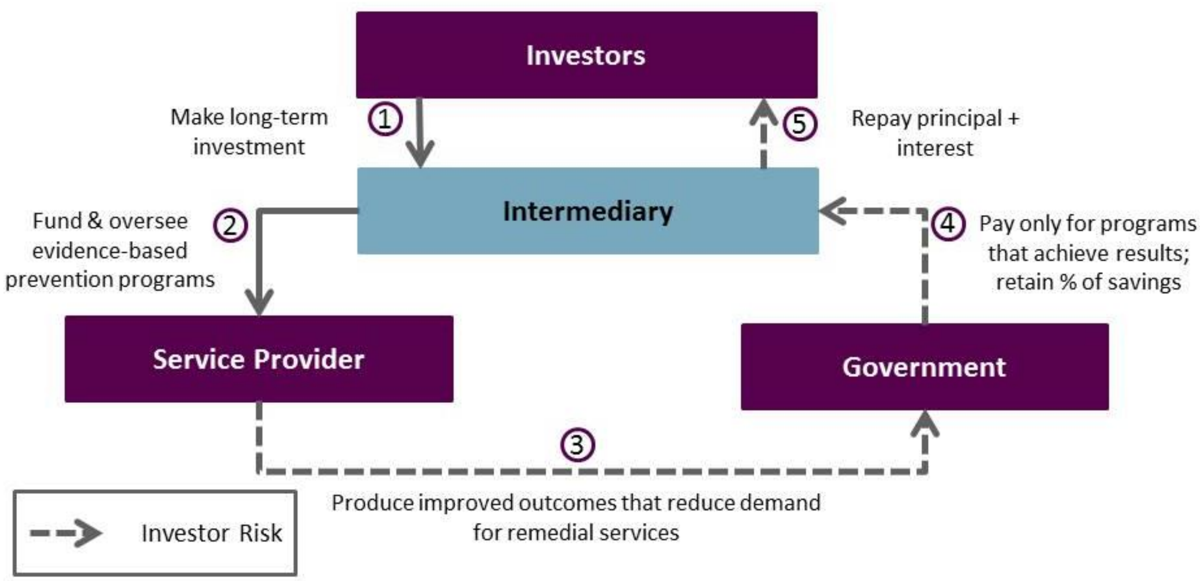
An Overview of Pay for Success in the United States

What is Pay for Success (PFS)?

PFS is a financing contract 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. PFS contracts are intended to diversify government funding of social services from reactionary, "emergency" investments only to prevention-oriented, low-risk investments.

How does PFS work?[1]



In the PFS 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 (financing capital called Social Impact Bond or SIB) 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]

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[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*; February 2011.

Where did they come from?

PFS contracts were created by Social Finance, a UK-based organization. The UK is currently testing the first PFS/SIB model to reduce prisoner recidivism in Peterborough, England, and the government will only pay if recidivism is reduced by 7.5 percent relative to a comparison group of similar prisoners.[3] The first results released late 2014 indicated an 8.4 percent drop in the number of short-sentence prisoners who have been reconvicted, compared to a control group. While a reduction of 10 percent was required to trigger an immediate payment to investors, as long as the rate remains above 7.5 percent, investors are on track to receive an initial payment in 2016.[4] The Ministry of Justice published a report to highlight critical components of PFS projects:

- The director overseeing the reduction of repeat offenders (employed by intermediary)
- Intermediaries possessing a broad range of skills and knowledge including negotiations, financial products, policy and relational skills
- Identifying constituent needs and characteristics and adapting intervention[5]

What is currently happening in the US?

President Obama launched PFS pilots in criminal justice and workforce development through the Departments of Justice and Labor, respectively. The Department of Labor awarded funds to Massachusetts and New York; the Corporation for National and Community Service has been administering over $11 million in PFS funds for economic opportunity, healthy futures and youth development. The first round awardees included the following:

- Corporation for Supportive Housing
- Green & Healthy Homes Initiative
- Harvard Kennedy School Social Impact Bond Lab
- Institute For Child Success, Inc.
- National Council on Crime and Delinquency
- Nonprofit Finance Fund
- Third Sector Capital Partners, Inc.
- University of Utah Policy Innovation Lab

The following map indicates SIB/PFS activity in the US to date.[6]

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[3] Ibid., p. 2.

[4] Social Finance UK; *Peterborough SIB reduces reoffending by 8.4%; investors on course for payment in 2016*; August 2014.

[5] Ministry of Justice*; Lessons Learned from the Planning and Early Implementation of the Social Impact Bond at HMP Peterborough*; May 2011.

[6] Minnesota Management & Budget Office; Third Sector Capital Partners; Associated Press; Office of Governor Andrew Cuomo; Goldman Sachs; Editable map courtesy of m62 Visual Communications.

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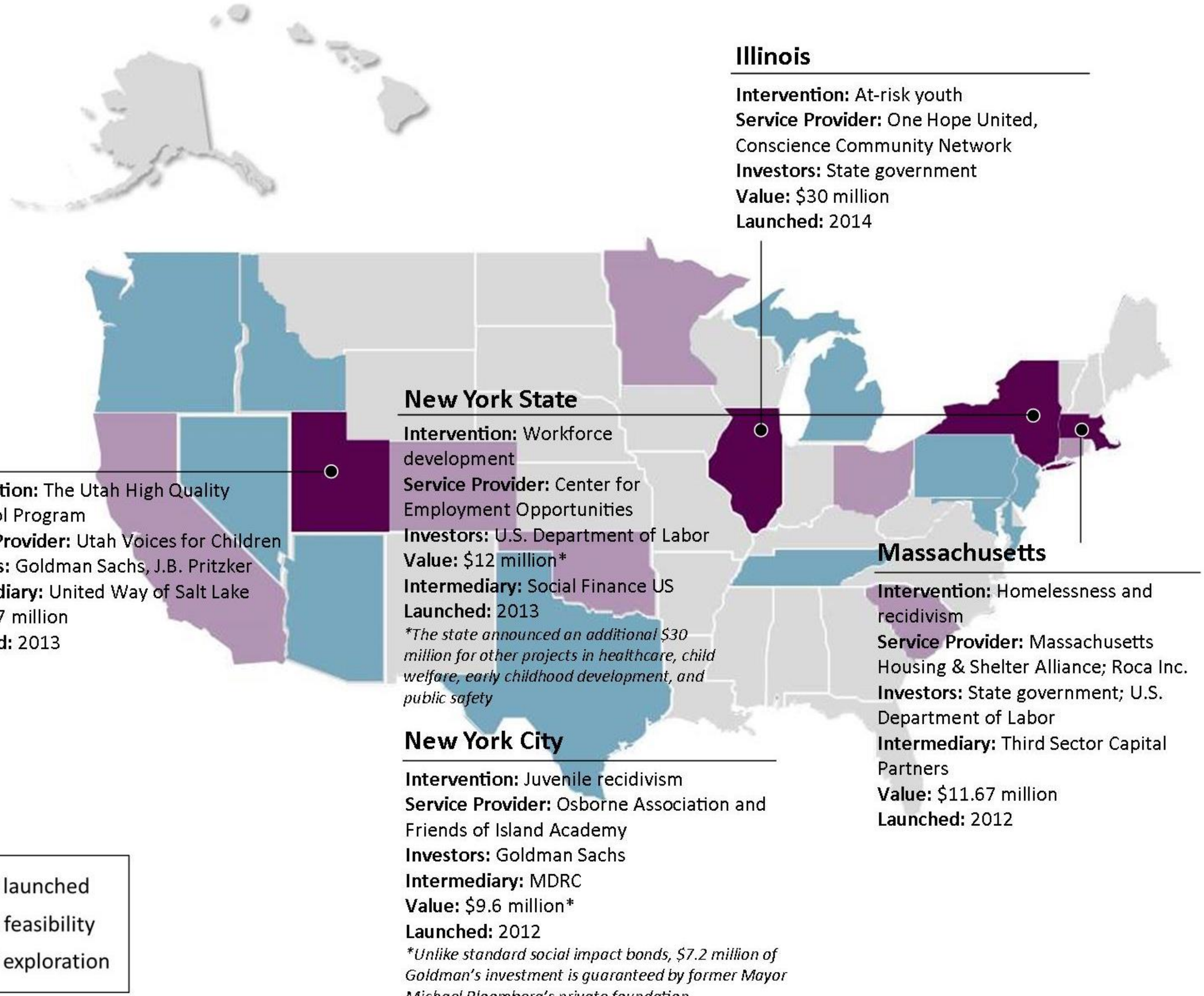

Illinois

Intervention: At-risk youth
Service Provider: One Hope United, Conscience Community Network
Investors: State government
Value: $30 million
Launched: 2014

New York State

Intervention: Workforce development
Service Provider: Center for Employment Opportunities
Investors: U.S. Department of Labor
Value: $12 million*
Intermediary: Social Finance US
Launched: 2013

**The state announced an additional $30 million for other projects in healthcare, child welfare, early childhood development, and public safety*

Utah

Intervention: The Utah High Quality Preschool Program
Service Provider: Utah Voices for Children
Investors: Goldman Sachs, J.B. Pritzker
Intermediary: United Way of Salt Lake
Value: $7 million
Launched: 2013

Massachusetts

Intervention: Homelessness and recidivism
Service Provider: Massachusetts Housing & Shelter Alliance; Roca Inc.
Investors: State government; U.S. Department of Labor
Intermediary: Third Sector Capital Partners
Value: $11.67 million
Launched: 2012

New York City

Intervention: Juvenile recidivism
Service Provider: Osborne Association and Friends of Island Academy
Investors: Goldman Sachs
Intermediary: MDRC
Value: $9.6 million*
Launched: 2012

**Unlike standard social impact bonds, $7.2 million of Goldman's investment is guaranteed by former Mayor Michael Bloomberg's private foundation*

What are the risks and challenges of SIB/PFS projects?[7]

- 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:

Focus on prevention

Multi-year track record (5+ years)

Record of rigorous evaluations

Statistically significant results

Sizable constituent base

Replicable and scalable intervention

Deliver taxpayer benefits in 5 years

[7] Liebman; *Social Impact Bonds*.

- Unlike traditional grants, PFS 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 PFS deployment in the US and recommend interventions in the following program areas for pilot testing[8]:

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

- PFS 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:

  - Annual expenses over $2M
  - More than 50 full-time employees
  - Receive $1M+ in government funding annually

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 PFS continues to grow. Some of this risk can be mitigated through open communication with PFS partners throughout the life of the project. Those 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.

[8] Social Finance; *Social Impact Bonds: An Overview*.