

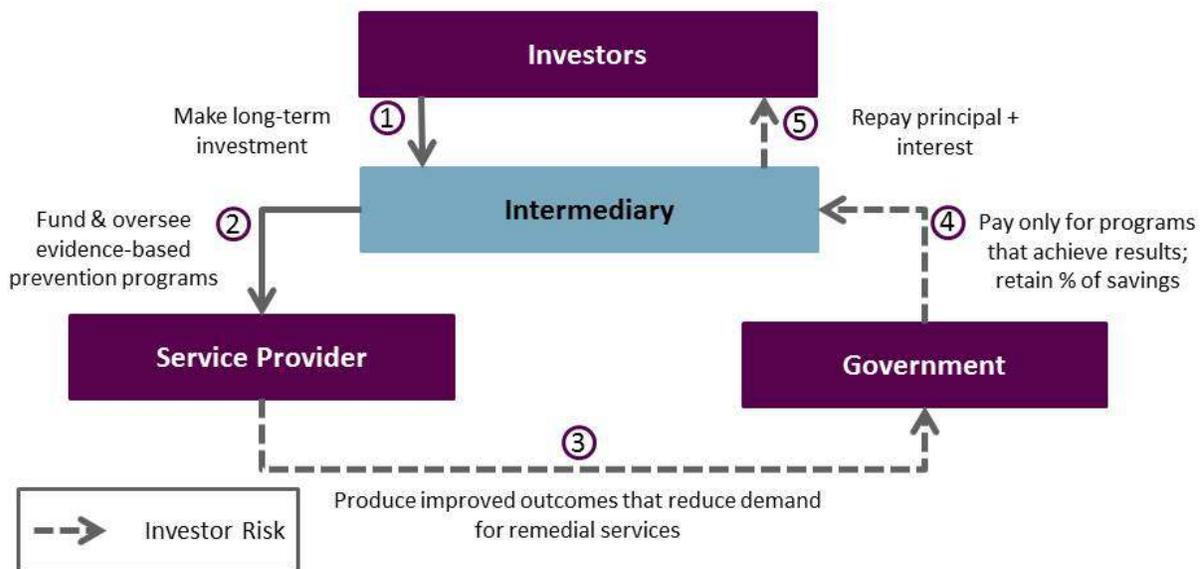


## An Overview of Pay for Success in the United States

### 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?<sup>1</sup>



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.<sup>2</sup>

<sup>1</sup> Graphic adapted from Social Finance US

<sup>2</sup> 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 tested the first PFS/SIB model to reduce prisoner recidivism in Petersborough, England, where the government would only pay if recidivism was reduced by 7.5 percent relative to a comparison group of similar prisoners.<sup>3</sup> While results released in 2014 indicated an 8.4 percent drop in the number of prisoners who had been reconvicted (10 percent was required to trigger an immediate payment to investors), the government announced an early phase out of the Petersborough SIB in early 2015.<sup>4</sup> In making the announcement, the government cited a change in approach to probation and rehabilitation. The new approach will take lessons learned from the Petersborough SIB and eliminate the need for intermediaries and investors.<sup>5</sup>

### **What is currently happening in the US?**

There are over 20 PFS contracts in various stages of development across the U.S. today, focused on criminal justice, foster care, home visitation, supportive housing, workforce development, early childhood education and mental health. One of the first PFS contracts to reach the market in U.S. was discontinued in July 2015 due to inability to achieve a reduction in recidivism. That contract in Rikers Island, New York administered evidence-based cognitive behavior therapy to youth in correctional facilities. The contract's investor, Goldman Sachs, lost \$1.2 million, with Bloomberg Philanthropies guaranteeing the remainder of the firm's \$7.2 million total investment.<sup>6</sup>

Other PFS contracts in the U.S. have not posted initial results, and while the Rikers Island PFS was not successful in achieving targets, sector capacity builders hope that even if these contracts do not generate return-seeking private investment, that more emphasis will be placed on the importance of evaluation, disseminating interventions that work and reshaping the way government deploys funds.<sup>7</sup> In the post-mortem of the Rikers Island SIB, many noted that the contract was a success in functioning as it was intended, which is impressive given its complicated nature, and it also underscored the difficulty in scaling interventions to social issues. See page 4 for a more comprehensive list of current PFS projects in the U.S.<sup>8</sup>

### **What are the risks and challenges of SIB/PFS projects?**

Now that the Petersborough and Rikers Island SIBs have been phased out and the U.S. is awaiting results for contracts in progress, some of the unanticipated consequences of this form of financing are coming to light. In Petersborough, the government phased out investors and intermediaries to work directly with service providers based on lessons learned from the SIB. In the U.S., there is growing concern that PFS is diverting funds away from service providers not involved in the contract, forcing nonprofit organizations to rely more heavily on fundraising. Additionally, while PFS contracts are creating opportunities for impact investing, opening the world of private investment dollars to solve social issues, this is not the norm in actual practice. All the risk of PFS contracts in the U.S. is being shouldered by

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<sup>3</sup> Ibid., p. 2.

<sup>4</sup> Social Finance UK; *Peterborough SIB reduces reoffending by 8.4%; investors on course for payment in 2016*; August 2014.

<sup>5</sup> Nonprofit Finance Fund; *Petersborough SIB to to Phase Out in 2015*.

<sup>6</sup> James Anderson and Andrea Phillips; *Huffington Post*; "What We Learned from the Nation's First Social Impact Bond;" July 2015.

<sup>7</sup> George Overholser; *Stanford Social Innovation Review*; "Response to 'The Payoff of Pay-for-Success;'" 2015.

<sup>8</sup> Minnesota Management & Budget Office; Third Sector Capital Partners; Associated Press; Office of Governor Andrew Cuomo; Goldman Sachs; Editable map courtesy of m62 Visual Communications.

philanthropists seeking mission alignment rather than financial returns.<sup>9</sup> Finally, while taxpayers did not officially shoulder the burden for the Rikers Island SIB, the government did offer a considerable amount of pro bono, in-kind support that is characteristic of many existing projects. This makes calculating the actual cost of SIBs difficult.<sup>10</sup>

Some of the challenges PFS players have faced in developing and implementing the model across communities in the U.S. are as follows:

- 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<sup>11</sup>

### **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 with statistically significant results
  - Sizable constituent base
  - Replicable and scalable intervention
  - Deliver taxpayer benefits in 5 years
- 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.

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<sup>9</sup> V. Katsuri Rangan and Lisa A. Chase; *Stanford Social Innovation Review*; "The Payoff of Pay-for-Success;" 2015.

<sup>10</sup> Donald Cohen and Jennifer Zelnick; *Nonprofit Quarterly*; "What We Learned from the Failure of the Rikers Island Social Impact Bond;" August 2015.

<sup>11</sup> Liebman; *Social Impact Bonds*.

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## Pay for Success Projects in the U.S.<sup>12</sup>

### Launched Projects

Location	Issue
Chicago, IL	Early Childhood Education
Massachusetts	Recidivism, Chronic Homelessness
New York	Recidivism, Workforce Development
Salt Lake County, UT	Early Childhood Education
Santa Clara County, CA	Chronic Homelessness

### Project Construction

Location	Issue
Connecticut	Child and Maternal Health, Substance Abuse, Child Welfare
Denver, CO	Homelessness
Illinois	Child Welfare
Massachusetts	Adult Basic Education
New York	Juvenile Recidivism
Santa Clara County, CA	Acute Mental Health
South Carolina	Child and Maternal Health
Washington, D.C.	Teen Pregnancy

### Project Feasibility

Location	Issue
Arkansas	Recidivism
Boise, ID	TBA
Clark County and Las Vegas, NV	Universal Pre-K
Connecticut	Universal Pre-K
Louisville, KY	Substance Abuse
Marion and Multnomah County, OR	TBA
Michigan	Child and Maternal Health
New Mexico	Homelessness
New York	Homelessness
North Carolina	Early Child Health
Orange County, CA	Child Welfare
Pennsylvania	TBA
Salt Lake County, UT	Recidivism, Homelessness, Child and Maternal Health
San Diego County, CA	Homelessness
San Francisco, CA	TBA
Sonoma County, CA	Universal Pre-K
Spartanburg, SC	Universal Pre-K
Travis County, TX	Homelessness, Teen Pregnancy
Virginia	Prenatal Home Visiting
Washington	Homelessness, Child Welfare
Washington, D.C.	Green Infrastructure

<sup>12</sup> Nonprofit Finance Fund; *Pay for Success U.S. Activity*.