



# Social Impact Bonds:

## Exploring an alternative financing strategy for children and families in Washington State

### Key Messages:

- Social Impact Bonds use private investments to implement or expand prevention and early intervention social programs.
- Private investors can earn a financial return if programs achieve desired goals and reduce future government expenses for the target population.
- SIBs are igniting interest internationally, with many pilot programs currently underway. This is particularly true in the United Kingdom.

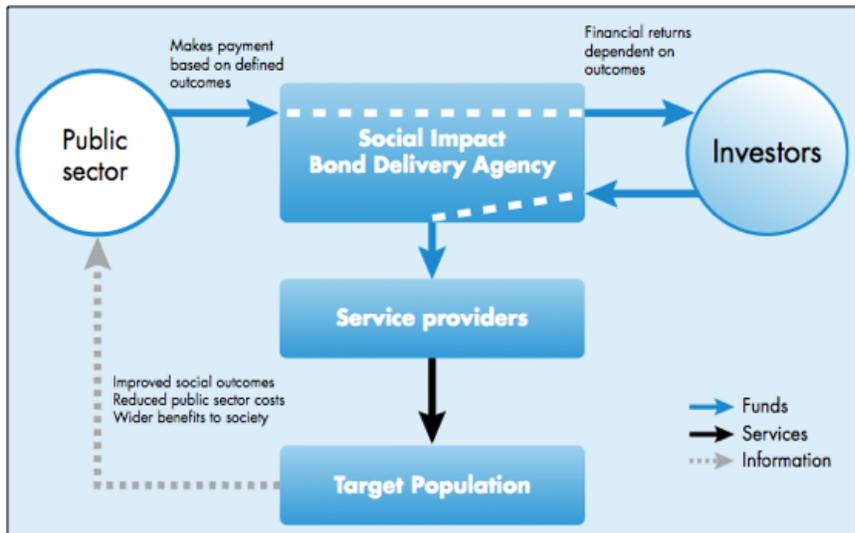
### Overview

Over the last ten years, governments facing revenue shortfalls across the globe have begun to explore new ways of financing social programs. One method that has witnessed an explosion of interest is the Social Impact Bond (SIB) model, an internationally adopted term used to describe a narrow range of financial techniques where private investments are used to implement or expand programs that have a high likelihood of offsetting future public costs. Variations of the SIB model exist (Human Capital Performance Bonds, Social Benefit Bonds, and Income Contingency Dividends), but they all share a belief that with investments in innovative, preventative solutions, it is possible to simultaneously improve the lives of vulnerable citizens and create financial savings for governments.

The basic SIB model begins when a consortium of stakeholders—private investors, social service agencies, the public sector, and evaluators—agree to work together to achieve a specific, common goal. The purpose of the consortium is to establish a formal,

collaborative relationship where investors provide upfront capital to implement or expand social service programs that are well-documented to improve client outcomes and reduce usage of costly downstream programs. This model is visually depicted below.<sup>1</sup>

Source: Social Finance, Ltd. (March 2010). *Towards a New Social Economy: Blended Value Creation through Social Impact Bonds*



The private resources are given, directly or indirectly (via an intermediary), to service providers, whom, in turn, provide prevention or early intervention services to clients or would-be clients of the public sector. The consortium can only choose services with strong histories of demonstrating successful outcomes and the capacity to produce quantifiable public benefits.

Once services are delivered to the target population, an evaluator is asked to determine whether the services were effective in producing both desired outcomes and public sector cost savings. If the evaluation determines that the intervention was successful, the public sector will release a predetermined portion of their savings back to investors, allowing investors to make a return. The outcome goals and the relationship between the public sector and investors are outlined by contract.

Many SIB models dictate that the private investors assume financial risk if the intervention does not achieve the desired outcomes. There are, however, other methods to balance risk between the investors, the service providers, and the private sector that doesn't place the entire burden solely on the private investors. For instance, some models use performance-based contracts to hold the private services providers accountable to achieving designated outcomes. In other scenarios, like the one just announced in New York City, the initial investment can be backstopped by a guarantor who will contribute resources in the event the intervention fails.

It is clear from decades of history that there are formidable obstacles to the public sector fully funding prevention and early intervention services. This is why there is substantial excitement across sectors about the possible success of this new alternative financing strategy. In this brief, we explore a few of the prominent pilot projects; discuss a range of implementation criteria; explore the potential applicability of SIBs to child welfare; and highlight some of the important caveats for the use of SIBs.

## International Pilot Program

Aware that the cost of housing individuals in prison is considerably higher than the cost of providing preventative services to support community re-entry, the Ministry of Justice in the United Kingdom pioneered the first SIB pilot in 2010. Seeking to reduce the rates of former Peterborough Prison inmates re-offending or having their parole revoked (recidivism), the Ministry partnered with Social Finance, Ltd. An arrangement was created in which private investors provided up-front capital to expand transitional services for newly released prisoners. Investors will receive outcome payments from the Ministry of Justice

(via Social Finance) if the population receiving the intervention has a reduced recidivism rate of at least 7.5% as compared with a similar group who did not receive the intervention. The pilot is still underway and no data on the effectiveness of the model will be available until 2014.

## Social Impact Bonds in the United States

Following the implementation of the first SIB pilot in Peterborough, many states have expressed strong interest in adopting SIBs to meet community needs. Federal grant funding was made available in 2012 through the Workplace Innovation Fund (part of the Department of Labor) to invest in "projects that demonstrate new, innovative strategies, or replicate effective evidence-based strategies."<sup>2</sup> Twenty million dollars have been reserved for grants that pilot a Pay for Success model. The term Pay for Success is often used interchangeably with Social Impact Bond, however, Pay for Success models generally include performance-based contracting features in the agreement. Applications are due December 2012. In the meantime, there are already a variety of emerging SIB projects in various stages of planning and implementation:

### New York:

In August 2012, Goldman Sachs announced that it will invest \$9.9 million in a SIB to address the nearly 50% recidivism rate of young male prisoners at Rikers Island, New York. Bloomberg Philanthropies has guaranteed a majority of the bond at \$7.2 million. The Vera Institute of Justice has been appointed to provide independent evaluation. The outcome goal is to reduce the rate of re-offending for a group of 3,400 inmates by 10%. Goldman Sachs plans to fully fund the four-year Adolescent Behavioral Learning Experience (ABLE) intervention in which teenage inmates will receive services such as education, training, recreational activities and counseling. Services will be delivered by two nonprofits and overseen by MDRC, a public policy research organization.<sup>3</sup> Goldman's investment demonstrates the growing interest in SIBs outside the philanthropic realm.

### Massachusetts:

The Massachusetts Executive Office of Administration and Finance awarded contracts to two non-profit groups to finance Pay for Success and Social Impact Bond contracts in August 2012. Social Finance, Inc., a

sister-organization of Social Finance, Ltd, is directing and managing these new pilot programs. The first program aims to save money on emergency services by providing supportive housing for hundreds of chronically homeless individuals, while the second aims to lower recidivism rates and improve education/employment outcomes among youths exiting the juvenile justice system.<sup>4</sup>

#### Minnesota:

In Minnesota, former executive vice-president of General Mills, Steve Rothschild, helped create the country's first Human Capital Performance Bonds (HCPB).<sup>5</sup> Rothschild founded Twin Cities Rise!, an organization providing job training and placement for unemployed adults, and estimated that the Return on Investment to the state from his program is substantial—over 600 percent. He reasoned that additional investment in services like this could yield valuable benefits to the state, both socially and financially. With assistance from Rothschild, Minnesota has become the first state to pass legislation on Pay for Success contracts, granting the state the ability to authorize bonds up to \$20m to finance social endeavors.<sup>6</sup>

In addition to the above states, California, Virginia, Connecticut, Ohio, Oregon, and Colorado are also taking steps to explore Social Impact Bonds.<sup>7, 8</sup>

## Target Areas for Social Impact Bonds

SIB pilot projects are intended to address social problems that result in high-cost use of government services. The structure of SIBs requires that intervention outcomes can be measured and quantified. The following target areas have been identified for SIBs:

#### Reducing Prisoner Recidivism:

*Peterborough Prison (England, Active Pilot)* – The goal of the Peterborough Prison pilot is to reduce prisoner recidivism by delivering an array of transitional services.<sup>9</sup> Launched in September 2010, this was the first active SIB pilot. It is two years into its planned six-year project duration.

*New South Wales (Australia, In Development)* – Social Finance and Mission Australia are developing a pilot program that will aim to assist 500 young adult repeat offenders.<sup>10</sup>

## Implementation Criteria

Social Impact Bonds are complex investment products. A number of key considerations are required to successfully launch a SIB. In 2011, the Young Foundation authored a report asserting there to be “7 Essential Criteria for a SIB:”<sup>19</sup>

- 1. Preventative Intervention** – The services are preventative in nature and sufficient funding is currently unavailable;
- 2. Improves well-being in an area of high social need** – The intervention improves social well-being and prevents or ameliorates a poor outcome;
- 3. Evidence of efficacy** – The intervention is supported by evidence of its efficacy and impact, giving funders confidence in its likely success;
- 4. Measurable impact** – It is possible to measure the impact of the intervention accurately enough to give all parties confidence of the intervention's effect, including a sufficiently large sample size, appropriate timescales and impacts that are closely related to the savings and relatively easy to measure;
- 5. Aligns incentives** – A specific government stakeholder achieves savings or lower costs as a result of actions undertaken by others. These savings need to be cash releasing and provide actual savings to government stakeholders.
- 6. Savings greater than costs** – The savings for the specific government stakeholders are relatively immediate and not much greater than the cost of the intervention and transaction costs. This provides investors with enough return to absorb the risks inherent in the plan, and can provide significant funds for investment; and
- 7. Government preference for a SIB** – Government policy for the specific agenda is keen on or at least open to the use of a SIB.

## Preventing/Reducing Out-of-Home Care for Children

*Manchester City Council (England, Announced)* – In March 2012, the Manchester City Council announced that they will pilot a SIB to improve child welfare outcomes. Their goal is to reduce the intensity of treatment settings for youth in foster care, moving children from residential settings to foster homes.

*Liverpool City Council (England, In Consideration)* – The Liverpool City Council is considering implementing a SIB pilot designed to reduce numbers of children in out-of-home care through increased child and family support services.

*Essex County Council (England, Announced)* – The Essex County Council has formally announced that they will be pursuing implementation of a SIB pilot to reduce foster care entry rates and length of stay through intensive in-home family therapy coupled with discretionary funds to assist families in meeting outstanding needs.

*Hammersmith & Fulham, Westminster, Birmingham and Leicestershire (England, Announced)* – These four municipalities announced SIB pilots as part of UK's Big Society Initiative. The pilots will address a range of issues within family settings.

*New South Wales (Australia, Announced)* – In March 2012, two pilot projects were selected in the areas of child protection and foster care.

## Reducing Chronic Homelessness

*Greater London Authority (England, Announced)* – In March 2012, the Greater London Authority announced a new pilot project to reduce homelessness rates.

## Enhancing Early Education and Improving Outcomes for Youth

*Location TBD (Scotland, Announced)* – Scotland is partnering with Perth & District - YMCA to work with young people to improve outcomes.

## Applicability to Child Welfare

Partners for Our Children predicts strong stakeholder interest in implementing a SIB project in Washington State. Child welfare presents a unique opportunity for the application of this kind of financing strategy. The primary

approach in child welfare is remedial in nature; family involvement is typically initiated after more optimal, early-intervention points have passed. Although there is increasing interest within child welfare to adopt new preventative strategies to avoid placing children in out-of-home care, there are significant hurdles to developing, implementing, or expanding a comprehensive solution. To complicate matters further, current financing mechanisms for child welfare incentivize public agencies to place children in costly out-of-home care environments instead of providing families with tools to remain intact. However, interventions with demonstrated ability to support families do exist, yet due to steep implementation and expansion costs, they are not taken to scale.

Per a McKinsey and Company report on bringing SIBs to the US, evidenced-based interventions for youth that may have potential for SIB use include: Multidimensional Treatment Foster Care (MTFC), Multisystemic Therapy (MST), Functional Family Therapy (FFT), and Brief Strategic Family Therapy (BSFT).

Given child welfare's heavy reliance on remedial interventions and since evidence-based interventions for families may reduce the long-term cost of ongoing system involvement, it seems appropriate to explore the potential applicability of a SIB pilot in Washington State.

## Caveats

Before Washington takes action, there are few caveats that must be clearly understood:

- SIB projects are very complex and require high levels of cross-sector collaboration and trust.
- Currently, there are no completed SIB pilots. There is only one example of an operational SIB and just a small handful of countries and states moving toward formal implementation.
- SIBs are not opportunities to test new interventions. Rather, they are best suited for expanding well-established interventions with quantifiable benefits.
- SIBs face fewer barriers when the chosen intervention has a single, well-defined, measureable outcome to follow (e.g. prisoner recidivism events, rates of student placement in special education, attainment of employment, etc.). SIBs that rely on interventions with diffuse cross-system benefits (e.g. Nurse-Family

Partnership) are harder to implement because they create cost savings across multiple agencies.

- Beyond financial resources to support the chosen intervention, reliable, timely data must be readily available to monitor outcomes.

## Next Steps

To help determine whether there is potential applicability for a SIB project in Washington State, a consortium of stakeholders might consider the following next steps:

1. Develop a baseline conceptual understanding regarding SIBs;
2. Assess the current services versus intervention landscape;
3. Identify promising interventions suitably matched to the needs of Washington state children and families;
4. Project costs and savings associated with the implementation or expansion of a proven intervention;
5. Identify key stakeholders critical to a pilot project implementation;
6. Assess interest among political stakeholders; and
7. Assess interest among potential financing entities.

### Information

For more information, please send your questions to:

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## Supplementary Resources

### Center for American Progress

- *What are Social Impact Bonds: An innovative new financing tool for social programs* (Brief) – March 22, 2012  
Available at: [http://www.americanprogress.org/issues/2012/03/social\\_impact\\_bonds\\_brief.html](http://www.americanprogress.org/issues/2012/03/social_impact_bonds_brief.html)
- *Social Impact Bonds: A promising new financing model to accelerate social innovation and improve government performance* (Report) – February 2011  
Available at: [http://www.americanprogress.org/issues/2011/02/pdf/social\\_impact\\_bonds.pdf](http://www.americanprogress.org/issues/2011/02/pdf/social_impact_bonds.pdf)
- *Inside a Social Impact Bond Agreement: Exploring the Contract Challenges of a New Social Finance Mechanism* (Brief) - May 2012  
Available at: <http://www.americanprogress.org/issues/open-government/report/2012/05/07/11619/inside-a-social-impact-bond-agreement/>

### Social Finance, Inc

- *A New Tool for Scaling Impact: How Social Impact Bonds can mobilize private capital to advance social good* (White Paper) – 2012  
Available at: <http://www.rockefellerfoundation.org/uploads/files/655fab01-83b9-49eb-b856-a1f61bc9e6ca-small.pdf>
- *A Technical Guide to Developing Social Impact Bonds* (Report) – March 2011  
Available at: [http://www.socialfinanceus.org/sites/socialfinanceus.org/files/Technical\\_Guide\\_Overview.pdf](http://www.socialfinanceus.org/sites/socialfinanceus.org/files/Technical_Guide_Overview.pdf)

### McKinsey & Company

- *From Potential to Action: Bringing Social Impact Bonds to the US* (Report) – May 2012  
Available at: <http://mckinseysociety.com/social-impact-bonds/>

### Non-Profit Finance Fund & The White House

- *Pay for Success: Investing in What Works* (Brief) – January 2012  
Available at: [http://payforsuccess.org/sites/default/files/pay\\_for\\_success\\_report\\_2012.pdf](http://payforsuccess.org/sites/default/files/pay_for_success_report_2012.pdf)

### Institutional Investor

- *The Latest in Socially Conscious Investing: Human Capital Performance Bonds* (Article) – January 10, 2012  
Available at: <http://www.institutionalinvestor.com/Popups/PrintArticle.aspx?ArticleID=2958534>

### Non-Profit Finance Fund

- *Risk Trade-off Continuum for Different Structural Approaches to Pay-for-Success Financing* (Report) - April 2012  
Available at: [http://payforsuccess.org/sites/default/files/pfsriskcontinuum\\_final.pdf](http://payforsuccess.org/sites/default/files/pfsriskcontinuum_final.pdf)

### State of Minnesota House of Representatives

- *House File 0681: An act relating to state government; authorizing issuance of state appropriation bonds; establishing the Minnesota pay for performance pilot program* (Legislation) – July 2011  
Available at: <http://wdoc.house.leg.state.mn.us/leg/LS87/HF0681.1.pdf>

### ReadyNation

- *Early Childhood "Pay for Success" Social Impact Finance: A PKSE Bond Example to Increase School Readiness and Reduce Special Education Costs* (Report) – March 2012  
Available at: [http://www.readynation.org/uploads/20120404\\_KauffmanReadyNationPKSEReport.pdf](http://www.readynation.org/uploads/20120404_KauffmanReadyNationPKSEReport.pdf)

### J.P. Morgan

- *Impact Investments: An emerging asset class* (Report) – November 29, 2010  
Available at: [http://www.jpmorgan.com/cm/cs?pagename=JPM/DirectDoc&urlname=impact\\_investments\\_nov2010.pdf&track=no](http://www.jpmorgan.com/cm/cs?pagename=JPM/DirectDoc&urlname=impact_investments_nov2010.pdf&track=no)

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