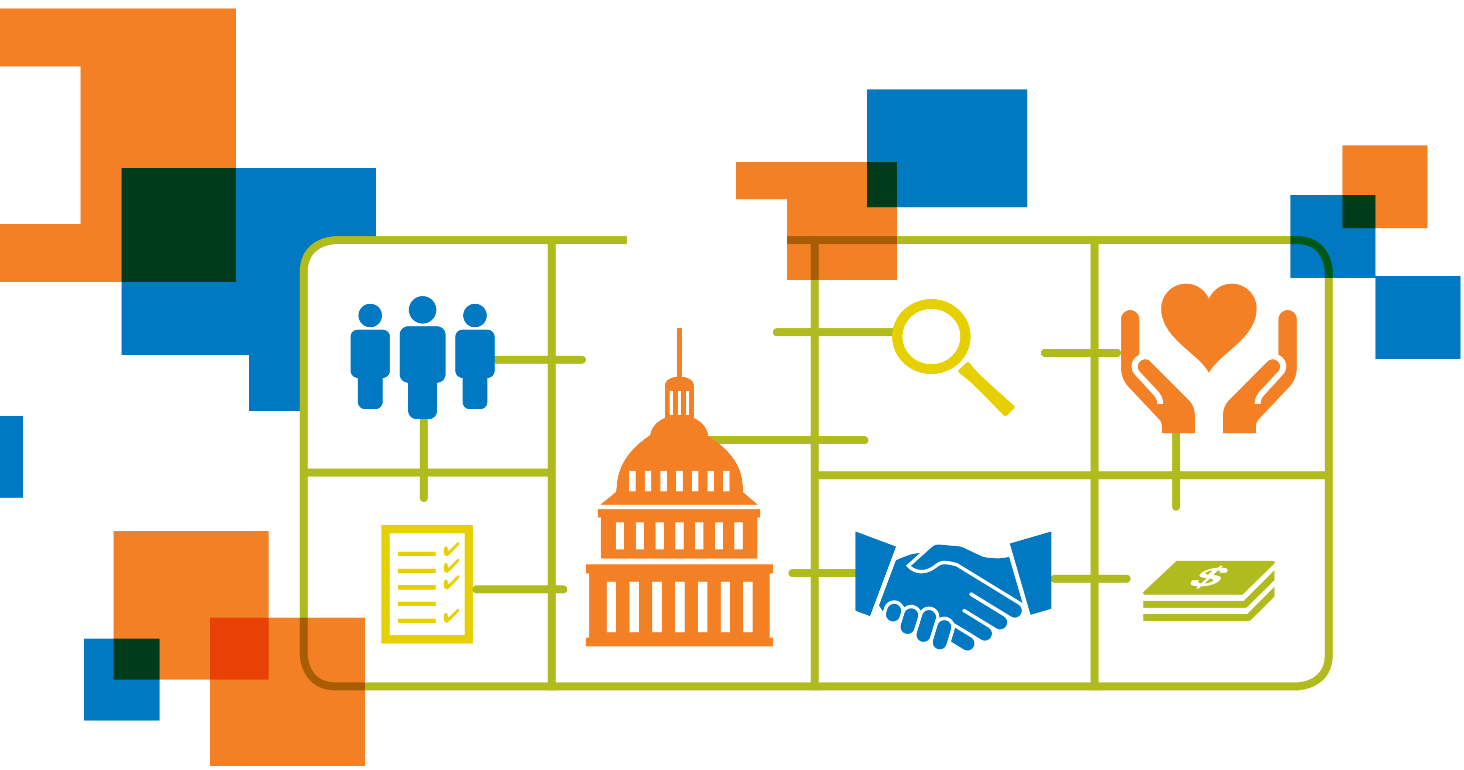


Will social impact bonds work in the United States?

As state and local governments consider a new financing mechanism to scale proven preventive solutions to social problems, research shows the potential and challenges.

Laura Callanan and Jonathan Law

There is considerable buzz in the United States about whether a new "pay for success" model of financing social solutions currently being piloted across the Atlantic could work on American soil. It's called a social impact bond (SIB), and the first—in fact, the only so far—was launched in September 2010 by an organization called Social Finance UK. SIBs are structured to get proven solutions to scale with no risk to public budgets—governments pay for the solutions only if they work. But despite this risk shifting, a SIB's structure involves several actors—each charging a fee or return. As a result, this tool is a more expensive way to scale programs than if government simply contracted directly with a service provider. These additional costs will be worth it in many cases, but SIBs won't be suited to every situation.

Local government officials in Massachusetts, New York City, and elsewhere are now investigating how SIBs could be applied in the areas of homelessness and criminal justice. Interest in SIBs has been bolstered by the Obama administration's focus in 2011 on pay-for-success programs and its 2012 announcement that two agencies would use funding competitions to support pay-for-success pilots.[1] According to that announcement, the Department of Justice intends to prioritize highly qualified 2012 Second Chance Act[2] applicants who incorporate pay-for-success models in their program design. The Department of Labor will also support pay-for-success pilots: by early spring, the Workforce Innovation Fund[3] will make as much as $20 million available for programs that "help individuals obtain employment."

But with only one example of a SIB to date, and not enough time for it to have developed a track record, a number of questions remain open: whether SIBs will work, where they could be most useful, and how they should be structured. As part of our Social Innovation practice's work in innovative finance and social impact assessment, we have conducted extensive research and interviewed more than 125 thought leaders in the government, nonprofit, and academic communities, as well as potential players in the SIB ecosystem, to determine the potential of SIBs in the United States. Our work was done in close cooperation with an advisory group that included representatives from all the stakeholder groups that will be represented in SIBs.[4] This research has resulted in a full assessment of how SIBs would work, including how roles, responsibilities, and capacity would be defined within the system for each type of stakeholder in a SIB partnership.

Scaling what works

Government social-welfare programs are often remedial in nature. They aim to address negative outcomes after they have already occurred (by incarcerating offenders or treating the health needs of chronically homeless people at the emergency room), rather than proactively addressing social needs before they become problems. These remedial efforts are costly. For example, we estimate that in 2010, federal, state, and local governments in the United States spent between $6 billion and $7 billion on remedial programs—such as shelters, food, and emergency medical care—for homeless constituents. Programs aimed at preventing social problems can save governments money and produce other societal benefits (for example, by building stronger community fabric, reducing the number of people living on the streets, or cutting crime rates).

For years, foundations and philanthropists have been investing in, and nonprofit solution providers have been piloting and implementing, a number of preventive programs—and proving that they work. For example, more than 20 studies have shown that permanent supportive housing (PSH) is a solution that is effective in addressing chronic homelessness and reducing its associated costs.[5] Constituents are given a permanent place in which they live as independently as possible and get supportive services such as primary health care, mental health care, substance-abuse treatment, and educational or vocational training. Benefits for constituents include higher rates of stable housing over the long term, decreases in substance-abuse rates, and improved mental health. For taxpayers, the benefit is lower comparative costs.

Yet foundations don't have the reach or the resources that governments have to fund proven solutions at scale. And nonprofit solution providers lack the reliable, multiyear support that would allow them to focus on scaling up their offerings. In the case of PSH, we estimate that the solution already benefits 88,000 people[6] who were formerly classified as "chronically homeless,"[7] but an additional 110,000 people still fall under this classification. PSH could also help other homeless populations, such as families and people who are HIV positive or mentally ill. As such, society could benefit if the current capacity for PSH were at least doubled.

Some programs like PSH—that have been piloted and demonstrated to work—do receive limited government support, but there is currently no formal structure through which foundations can hand off proven programs to government for scaling. Although people generally understand how an ounce of prevention is worth a pound of cure, there is often hesitation on the part of government to move money from legacy remediation programs to new preventive solutions. While providing shelter on a cold night or delivering emergency medical care seem necessary and yield immediate, tangible results, prevention efforts are often viewed as "soft" or somewhat theoretical.

Showing that a program like PSH is keeping people from sleeping on the streets and preventing such emergency costs is more like proving a negative. Then there's the question of risk appetite. Yes, the solution may have worked in other cities or states, but what if it doesn't deliver after this government has invested funds in it? Then the public would pay twice: once for the preventive measure that didn't work, and then again for the remedial services that become necessary in the wake of the failure.

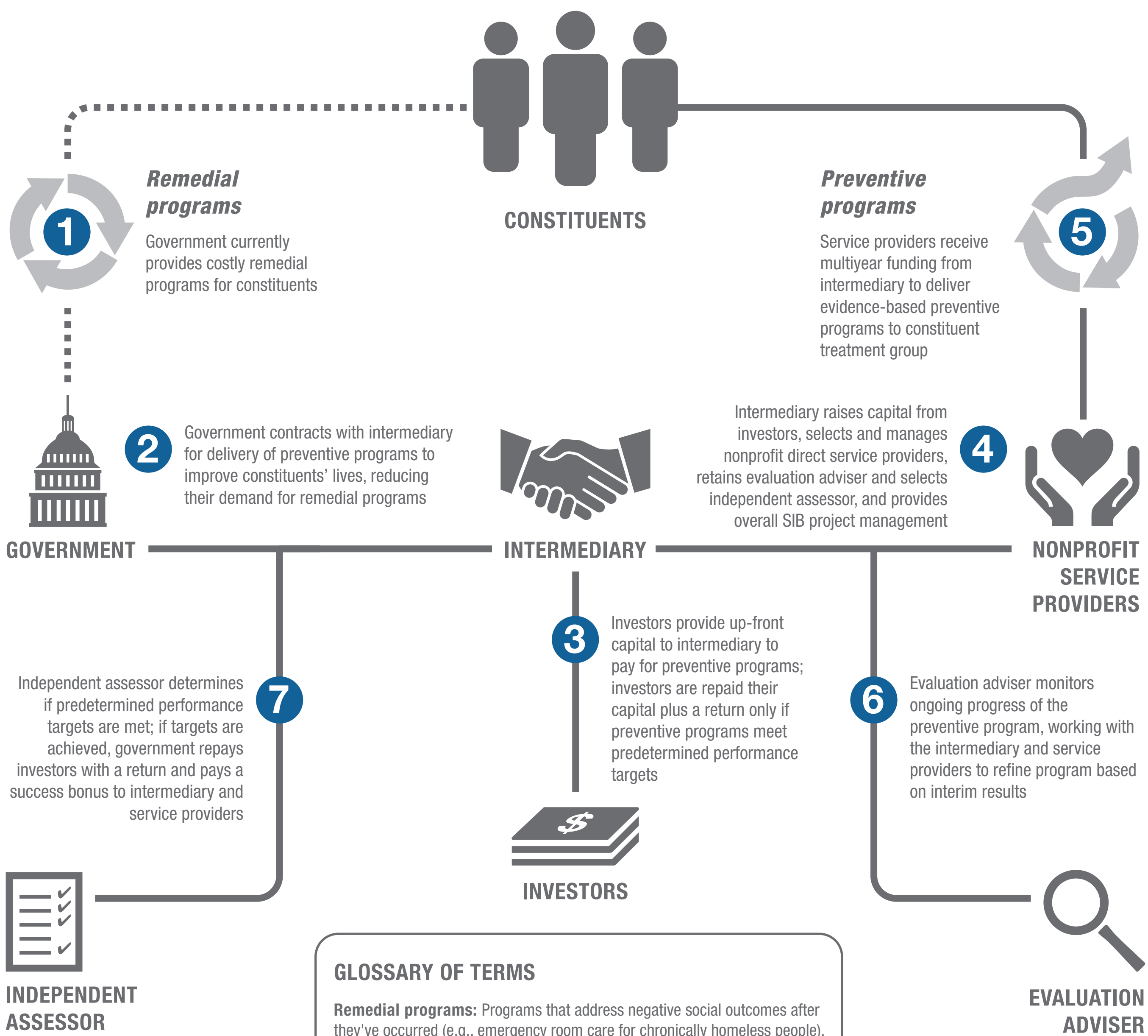
Following the path to social impact

We have created a graphic to illustrate how SIBs work to scale preventive solutions (see page 4). The numbered points we discuss next correspond to the numbers on the graphic to highlight the critical interactions that occur among the stakeholders in a SIB.

1. Constituents are the heart of a SIB's work. They are the people who will directly benefit from the social interventions funded and scaled through a SIB. They might include chronically homeless or incarcerated individuals. State and local governments already provide (or contract with nonprofit service providers who provide) remedial services to these constituents, paid for out of taxpayer funds.

2. Knowing that there are preventive solutions proven to improve constituents' lives and reduce the need for remedial services, the state or local government enters a contract with an intermediary to develop a SIB. (Note that without government support, SIBs will not happen.) Under the contract, the intermediary takes responsibility for identifying evidence-based program solutions, raising the money to bring them to scale, conducting ongoing project management, and working with nonprofit service providers to ensure effective implementation. The government agrees to repay investors—via the intermediary—capital plus a return on investment if the program meets specific, defined metrics (for instance, reduced recidivism). If the SIB performance targets are met, the intermediary will receive

The SIB ecosystem



GLOSSARY OF TERMS

Remedial programs: Programs that address negative social outcomes after they've occurred (e.g., emergency room care for chronically homeless people).

Preventive programs: Programs that reduce negative social outcomes for constituents and reduce demand for remedial programs (e.g., permanent supportive housing for chronically homeless people).

Constituent treatment group: Constituents who receive preventive programs. Program results for the treatment group are compared with constituents who do not receive preventive programs (i.e., the constituent control group) who did not receive similar services.

a success fee, pay some to the service provider as a performance bonus, and pay out the rest to the investors. An intermediary will have experience in the content area related to the social problem, in financing, and in project management. The intermediary links all the other stakeholders in the service of the constituents.

3. In the near term, SIB investors likely will be private foundations or major philanthropists who prioritize benefits to society over financial rewards for themselves. These investors transfer funds through the intermediary to pay the nonprofit provider to deliver services, cover a management fee for the intermediary, and pay the costs of evaluation. SIB investors understand that they will be repaid only if the intervention achieves the performance targets laid out in the contract.

4. The intermediary then provides multiyear funding to one or more nonprofit service providers to scale up preventive solutions. As noted earlier, these service providers stand to receive a bonus if they deliver the promised outcomes.

5. The nonprofit service providers then scale up their operations and deliver preventive interventions to an expanded group of constituents.

6. As the nonprofits provide services under the multiyear SIB contract, the intermediary will want to monitor performance and ensure that the intervention continues to deliver as expected as it reaches scale. To do this, the intermediary hires an evaluation adviser. The evaluation adviser is involved in a number of activities, including determining the evaluation approach, defining performance outcomes, monitoring progress, and suggesting course corrections if needed. The evaluation adviser is paid on a fee-for-service basis out of SIB funds.

7. As it comes time to determine whether the performance targets in the SIB contract have been met, an independent assessor reviews the constituent treatment group relative to a counterfactual and reports on whether the target outcomes have been achieved. As with the evaluation adviser, the independent assessor is paid out of SIB funds only on a fee-for-service basis. Based on the assessor's report, the government knows whether, and how much, to repay investors according to the terms of the SIB.

This article is meant to provide some context on SIBs, why they could be important, and who would have to be involved to make them work. In the coming months, we will issue a report with our findings in these areas, as well as other research we did to develop an in-depth view of evidence-based interventions in the areas of homelessness and criminal justice (which experts consider to be the best places to test the water for SIBs), an estimate of how many people could be helped by proven programs, a snapshot of current government spending on remediation efforts, and an assessment of whether service providers currently have the capacity to bring these solutions to scale. The report will also include a pro forma analysis we developed to evaluate the time frame and economics of a hypothetical SIB in juvenile justice to illustrate how an actual SIB might work, and it will discuss our plans to help build a set of tools to support the development of SIBs.

A SIB is simply one new type of tool for scaling solutions to social sector challenges. But it is one that continues to push forward the conversation about several basic tenets—such as increased multistakeholder collaboration and a focus on results and alignment of incentives—that can be applied in other ways, as well. Whether or not SIBs are successful, they have made a meaningful contribution to discussions about government performance transformation. If they ultimately galvanize a new wave of system improvement and pave the way for better alternative models, their impact will be truly significant.

[1] Cecilia Muñoz and Robert Gordon, "Pay for success: A new results-oriented federal commitment for underserved Americans," *The White House Blog*, January 24, 2012, www.whitehouse.gov/blog/2012/01/24/pay-success-new-results-oriented-federal-commitment-underserved-americans.

[2] The Second Chance Act was designed to improve outcomes for people returning to communities from prisons and jails. The Department of Justice solicitations for three Second Chance Act grant programs designed to reduce recidivism were announced February 24 and are due April 24. For more, see "Bureau of Justice Assistance releases three Second Chance Act solicitations," the National Reentry Resource Center, February 24, 2012, www.nationalreentryresourcecenter.org/announcements/bureau-of-justice-assistance-releases-three-second-chance-act-solicitations.

[3] The Workforce Innovation Fund is a Department of Labor grant program that funds innovative, evidence-based programs to improve education and employment outcomes for program beneficiaries. The Department of Labor solicitations were announced December 22, 2011, and were due March 22, 2012. For more, see www.doleta.gov/workforce_innovation.

[4] Our advisory group includes the following people: Amit Bouri, the Global Impact Investing Network; Cathy Clark, the Center for the Advancement of Social Entrepreneurship, Duke University, the Fuqua School of Business; Joel Copperman, the Center for Alternative Sentencing and Employment Services; Kristin Giantris, Nonprofit Finance Fund; Steve Goldberg, Social Finance US; Megan Golden, Wagner Graduate School of Public Service, New York University; John Goldstein, Imprint Capital; Rosanne Haggerty, Community Solutions; Lisa Hall, Calvert Foundation; David Hunter, Hunter Consulting; Jitinder Kohli, Center for American Progress; Patrick Lawler, Youth Villages; Natasha Lifton, Seedco; JoAnne Page, the Fortune Society; Tracy Palandjian, Social Finance US; and Drew von Glahn, Third Sector Capital Partners. We appreciate their help and contributions to our report. We also thank the members of our steering committee: Nancy Barrand, the Robert Wood Johnson Foundation; Stephanie Cohn Rupp, Omidyar Network; Jacob Harold, the William and Flora Hewlett Foundation; Jessica (Kippy) Joseph, the Rockefeller Foundation; Justina Lai, the Rockefeller Foundation; and Clara Miller, the F. B. Heron Foundation. Our work has been supported by grants from the F. B. Heron Foundation, Omidyar Network, the Robert Wood Johnson Foundation, the Rockefeller Foundation, and the W.K. Kellogg Foundation.

[5] Studies include analyses on interventions in Chicago, Cleveland, Connecticut, Denver, Maine, Massachusetts, Minnesota, New Orleans, New York, Oregon, Philadelphia, Rhode Island, Seattle, San Diego, San Francisco, and Washington, DC.

[6] We derived this estimate by extrapolating to the 236,798 total PSH beds available in the United States the results of a study that found that 37 percent of PSH beds in sample communities were occupied by individuals who had been chronically homeless. See *The 2010 annual homeless assessment report to Congress*, US Department of Housing and Urban Development, p. 41.

[7] The US Department of Housing and Urban Development (HUD) generally considers a person chronically homeless if he or she is an unaccompanied disabled individual who has been continuously homeless for more than one year (for more information, visit hud.gov/offices/cpd/homeless/chronic.cfm). In 2010, there were an estimated 109,812 individuals who met the department's definition of chronic homelessness. See *The 2010 annual homeless assessment report to Congress*, US Department of Housing and Urban Development, p. 8.

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