Social Impact Bonds:
An Evolving Tool for Financing Social Innovations

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Social Impact Bond (also known as Pay For Success)
Basic Definition

An agreement or contract with the public sector or governing authority, whereby it pays for improved social outcomes and part of the savings achieved is passed along to the original investors.

• Not a true bond, per se (no guaranteed return of principal)

• Investors are typically those who interested in not just return on investment but also social impact or benefit
Why?

There are:

• Increasing demands for money to fund public sector programming and services,

• Decreasing revenues (era of “no new taxes” or even reduced taxes)

• Increasing pressures on private philanthropic funding for social programs with evidence-based solutions

Therefore:

“A market-oriented funding solution to government expenditures…”

*Forbes*, 2014

Thus:

An era of the convergence of capitalism with government and social services begins....
Peterborough Prison in the United Kingdom issued one of the first social impact bonds anywhere in the world. The bond raised 5 million pounds from 17 social investors to fund a pilot project with the objective of reducing re-offending rates of short-term prisoners. The relapse or re-conviction rates of prisoners released from Peterborough will be compared with the relapse rates of a control group of prisoners over six years. If Peterborough's re-conviction rates are at least 7.5% below the rates of the control group, investors receive an increasing return that is directly proportional to the difference in relapse rates between the two groups and is capped at 13% annually over an eight-year period.

However, somewhat similar to “performance contracts” in US such as energy savings agreements in 70s and 80s where a company fronted costs of equipment and split savings with the owner.
Hypothetical Social Impact Bond Cost – Benefit Diagram

- Total Cost
- Investment
- Benefit (If Successful)
- 120% ROI (Success)
- 0% ROI (Failure)
“Impact Bonds Are Going Mainstream”

**FIGURE 1 SOCIAL IMPACT BOND MECHANICS**

1. **INVESTORS**
   - Make long-term investment
   - Repay principal + ROI

2. **INTERMEDIARY**
   - Fund & oversee less costly, evidence-based prevention programs
   - Pay only for programs that work; retain % of savings
   - Produce improved outcomes that reduce demand for remediation services

3. **NONPROFIT**

4. **GOVERNMENT**

5. **NONPROFIT**

**FORBES**

Opinion: Sep 15, 2014
Example: New York City (Rikers Island Project) 2012

PRIVATE INVESTORS

Goldman Sachs
Makes a $9.6 million loan to MDRC to operate the ABLE program at Rikers Island.

Bloomberg Philanthropies
Gives MDRC a $7.2 million grant to guarantee part of Goldman's loan. Also pays MDRC for pilot and intermediary costs.

INTERMEDIARY

MDRC
Responsibilities include:
- Setting up the financial arrangements.
- Selecting the intervention and the service provider.
- Training staff.
- Piloting the intervention.
- Monitoring implementation fidelity and program participation.
- Serving as primary liaison among all partners.

If recidivism goals are met:
- MDRC receives a payment from the city, which is used to reimburse Goldman for the initial loan plus a return.
- MDRC works with Bloomberg Philanthropies to reprogram the $7.2 million for future efforts.

If goals are not met:
- MDRC uses Bloomberg Philanthropies' $7.2 million to repay Goldman.

PAYMENT IF OUTCOMES ACHIEVED

Program implementation

INDEPENDENT EVALUATION OF THE PROGRAM

PROGRAM OPERATORS

Osborne Association and Friends of Island Academy
Non-profit service providers who deliver the intervention to 16- to 18-year-old youth detained at Rikers.

Vera Institute of Justice
Conducts a quasi-experimental evaluation.

Mayor's Fund to Advance NYC
Pays for the evaluation.
FIGURE 2
U.S. progress on social impact bonds

- State has an active social impact bond underway
- State is exploring pay for success options

California
- First pilot program testing feasibility of social impact bonds in preventive health

Colorado
- Received support from Harvard Kennedy School Social Impact Bond Lab, or HKS SIB Lab

Connecticut
- Passed legislation enabling the state to enter into social impact bond contracts, June 2012
- Received support from HKS SIB Lab

Illinois
- Received support from HKS SIB Lab

Maryland
- Bill introduced in House of Delegates to create a task force to study social impact bonds

Massachusetts
- Launched social impact bond to reduce recidivism among juvenile offenders in December 2013
- Negotiating a second social impact bond for chronic homelessness
- Received support from HKS SIB Lab
- Passed legislation, January 2012

Michigan
- Received support from HKS SIB Lab

New York City
- Launched first social impact bond to reduce recidivism among juvenile offenders in August 2012

New Jersey
- Bill in state legislature to administer five-year social impact bond pilot program and study on health care

Ohio
- Received U.S. Department of Justice Second Chance Act grant
- Received support from HKS SIB Lab

Oregon
- Pay-for-Success pilot included in governor’s 2013-2015 budget proposal

Pennsylvania
- Pay-for-Success legislation introduced in 2013

South Carolina
- Pay-for-Success legislation introduced in 2013
- Received support from HKS SIB Lab

Utah
- Launched social impact bond to fund early childhood education in 2013

Washington, D.C.
- Issued procurement for feasibility study in 2013

Washington state
- Bill introduced in the House of Representatives to enable the use of social impact bonds and other pay-for-performance vehicles

Rapid Growth in Public Policy Tools For SIBs

![Map of the United States with states colored based on their SIB activities]

- **Gray**: Initiated exploration of PFS/SIBs (e.g., legislation, procurement)
- **Blue**: Developing PFS/SIB project
- **Orange**: Launched SIB project

*Accurate as of September 2014*
“Denver homeless initiative would be latest to tap social impact bonds”

DenverPost.com - 01/26/2015

“Sammy B. Taylor stands outside the Renaissance Stout Street Lofts in Denver on Thursday. Taylor moved into the Colorado Coalition for the Homeless.”
Pay for Success (PFS) contracts enable governments to

*partner with service providers and private sector investors or philanthropists* to fund and provide

*interventions to increase economic opportunity, support healthy futures, and promote child and youth development*. PFS contracts are typically used for preventative programs and are

*intended to generate reductions in government spending* for other programs. HB 15-1317 outlines the timeline and required elements of a Pay for Success contract.
House Bill 15-1317 (Continued)

The bill authorizes the Office of State Planning and Budgeting (OSPB) to

*enter into PFS contracts with a lead contractor, which is an organization, or one or more local governments, to provide these interventions directly or via subcontracts with other providers.

*A new state Pay for Success fund containing the government’s cost savings would be used to pay the lead contractor if the contract’s performance targets are met. The bill requires an independent evaluation to determine if the intervention met the performance targets.

**The lead contractor uses its funding or otherwise raises private capital to pay the costs of delivering services.
Who’s structuring these financing tools?

Federal? Yes

States? Yes

Cities? Yes

Other? Maybe Counties, Townships, Health/Hospital Districts, etc.
Pros/Cons/Tax Issues
Pros/Cons/Tax Issues

Pros?
• New sources of dollars on the table
• Shifts financial risk to private sector; ideally lowers cost to government in long-run
• Demands evidenced-based approach
• Encourages creative solutions, rather than status-quo (or “tweaking” usual with government)
• Recycles limited philanthropic dollars

Cons?
• Unfamiliar cultures – government, social services, philanthropies, and corporate investors
• In general, more likely benefits larger non-profits that can respond to the “big issues”
• Transaction costs, excessive guarantees, legislative concessions or modifications to concept reducing probable positive outcomes
• Demands government to “set aside” funds for payout / ties up even more dollars
• May cut into outright granting by foundation donors and/or corporate giving
• Risks reputations for failed ventures (creative solutions may carry greater risk)
• Focus on short-term solutions to secure “pay off” – little data on longer term outcomes

Tax Implications?
• Corporate lobbying for tax incentives that may further reduce government revenue
• Private Benefit Implications on the Tax Exemption Status may be at-risk for not for profit agencies depending upon role and government rulings
Selected References


Or, just search for “Social Impact Bonds” or Pay for Performance”
Questions/Comments?

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