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SOCIAL IMPACT BONDS

A Guide for State and Local Governments



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Why We Need a New Approach

Each year, governments spend hundreds of billions of dollars addressing social problems. But in most cases, we have no idea how effective this spending is. Performance is rarely assessed, and measurement tends to focus on tracking the number of people served and the amount of service provided rather than the outcomes that are achieved.

At the same time, tight budgets cause us to under-invest in prevention, even when we know that doing so will lead to greater expenditures on remediation down the road. Our fiscal predicament also threatens to stifle innovation – how can we come up with the resources to test promising new ideas when we can't even afford to pay for what we are already doing? And we are simply not making rapid enough progress in addressing social problems. From recidivism to school readiness, and obesity to workforce development, we lack proven, cost-effective, scalable strategies.

Current funding mechanisms create barriers to innovation

Imagine a world in which governments define high-priority populations (e.g. youth aging out of foster care), regularly measure how the target populations are faring on key outcomes (e.g. educational attainment, transitions into the workforce), experiment by funding different interventions to attain outcomes, and create a culture of continuous improvement in which agencies are held accountable for achieving better outcomes through both proven interventions and innovative new strategies. Unfortunately this is not the world we live in with most of our social spending. There are three features of current funding mechanisms that inhibit innovation:

Government budgeting focuses on paying for inputs rather than achieving outcomes

Most social service spending today funds organizations to deliver a set quantity of services rather than to produce results. Outcomes are rarely assessed,

making it hard, for example, to reallocate resources based on the comparative performance of different service providers or to stop spending money on programs that don't work.

Budgets are built in a backward-looking manner

Most budgets are built around funding the same things that were funded the previous year with small adjustments for inflation. In some cases, legislatures require that the same providers be hired year after year to deliver the exact same, possibly ineffective, services. Governments lack a systematic way to work with innovative non-profits to test and scale up promising new solutions. And fear of public scrutiny makes it hard to take the risks associated with trying new things and rigorously assessing them.

Time horizons are too short

While it is relatively easy for a governor or mayor to set up an interagency task force to tackle a tough issue and to get the task force to meet a few times, rarely do these efforts manage to sustain energy over the several years necessary to achieve results. Political leadership turns over; new priorities emerge; or inadequate provision of staff time and other resources dooms the effort. Moreover, fiscal realities make it difficult to make preventive investments even when those investments can deliver large savings in future budgets. This problem is exacerbated when the required investments would occur in one agency's budget, while the savings would appear in another's.

Governments around the world are starting to recognize the need for a new approach to social services that places its emphasis on identifying innovative ideas, testing their effectiveness, and scaling up the interventions that prove successful. The main hurdles to embarking on this new approach are a lack of up-front funding, the inability to sustain focus on performance, and a reluctance to take on the risk that a promising, but unproven, idea might fail. The social impact bond model is designed to overcome these hurdles.

The Social Impact Bond Model

The social impact bond model is a promising new approach that combines performance-based payments and market discipline. It has the potential to improve results, overcome barriers to social innovation, and encourage investments in cost-saving preventive services. It does this by ensuring that public funding goes only to those interventions that are clearly demonstrating their impact through rigorous outcome-based performance measures, transferring the risk of program failure to the private sector, and providing an effective springboard from which state and local governments can determine which interventions work and then scale up successful innovations.

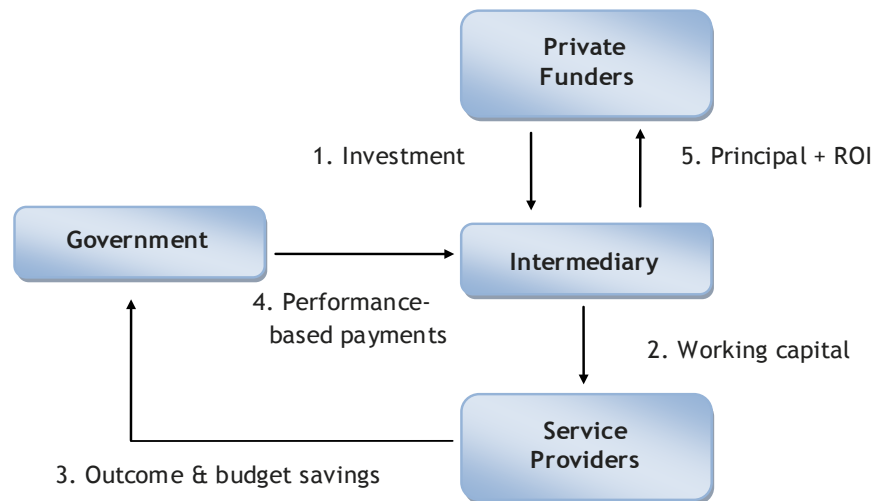
Under the most common social impact bond model, the government contracts with a private sector intermediary to obtain social services. The government pays the intermediary entirely or almost entirely based upon achievement of performance targets. Performance is rigorously measured by comparing the outcomes of individuals referred to the service provider relative to the outcomes of a comparison or control group that is not offered the services.¹

If the intermediary fails to achieve the minimum target, the government does not pay. Payments typically rise for performance that exceeds the minimum target, up to an agreed-upon maximum payment level. The intermediary obtains operating funds by raising capital from private commercial or philanthropic investors who provide upfront capital in exchange for a share of the government payments that become available if the performance targets are met. The intermediary uses these operating funds to contract with one or more service providers to deliver the interventions necessary to meet the performance targets.²

¹ The term “Social Impact Bond”, which was coined in the UK, has led to some confusion. The private sector financing arrangement is not a typical debt instrument and these transactions do not require the government to issue debt. To avoid these misperceptions, the federal government tends to call these projects “pay-for-success contracts.”

² Other variants of this model are possible. For example, the government could contract with the service provider, and the service provider could raise the working capital directly.

Social Impact Bond Structure



Governments are attracted to this approach because it shifts the risk of innovation from taxpayers to private investors, provides resources for preventive investments, and offers a way to make more rapid progress in achieving social policy goals. From the government's perspective, this is simply a performance-based contract. If the project succeeds, the government pays the full cost of services, though in some cases achievement of performance goals may produce budgetary savings that partly or fully offset the cost of the services.

Service providers are attracted to this approach because it provides stable multi-year funding and begins a relationship with the government that can enable operations to scale rapidly if the provider is able to demonstrate program effectiveness.

Philanthropic investors are attracted to this model because it provides rigorous performance assessments of the initiatives they are funding and offers a way to massively scale these initiatives through government funding if they are proven successful.

Commercial investors are attracted to the model because they see the opportunity to get involved in a promising new market, providing growth capital to social service providers.

SIBs Currently Underway/ in Development

United Kingdom

The U.K. Ministry of Justice is performing the first test of the social impact bond approach at a prison in Peterborough, England where it has contracted with a nonprofit intermediary, Social Finance U.K., to provide services to prevent reoffending by 3,000 short-sentence male prisoners over six years. Social Finance has raised \$8 million from social investors to finance service delivery by another nonprofit, the St. Giles Trust. The government will make payments to Social Finance only if the reoffending rate falls by at least 7.5 percent compared to the recidivism rate in a comparison group of similar prisoners at other prisons that are not receiving the intervention.

If payments are earned, they will be made in the fourth, sixth, and eighth years, based on outcomes achieved in working with prisoners during three consecutive two-year periods. Social Finance estimates that if this intervention is successful and scaled across the U.K., reductions in incarceration costs would more than cover the cost of the services. Additional SIB projects are now in operation in the U.K., including efforts to tackle a variety of family problems, reduce homelessness, and provide increased support for at-risk youth.

U.S. Federal Government

In the U.S., interest in social impact bonds is growing rapidly. President Obama proposed funding for pay-for-success initiatives in his 2011, 2012 and 2013 budgets. The U.S. Department of Labor recently issued a grant solicitation that would fund up to \$20 million of pay-for-success contracts.

New York City

New York City has created the first U.S. SIB, an initiative that is providing services to 16 to 18 year olds who are jailed at Rikers Island with the aim of reducing recidivism and related budgetary and social costs. Services are being delivered to approximately 3,000 adolescent men per year, from Sep-

tember 2012 to August 2015. MDRC, a nonprofit research organization, is serving as the intermediary, overseeing day-to-day implementation of the project and managing the two nonprofit service providers who are delivering the intervention. Goldman Sachs is funding the project's delivery and operations through a \$9.6 million loan to MDRC. The city will make payments that range from \$4.8 million if recidivism is reduced by 8.5 percent to \$11.7 million if recidivism is reduced by 20 percent. Bloomberg Philanthropies is guaranteeing the first \$7.2 million of loan repayment.

Massachusetts

Massachusetts issued a request for information (RFI) in May 2011 to solicit ideas for pay-for-success projects. In January 2012, the Commonwealth launched procurements to obtain intermediaries and providers for two social impact bond projects, and announced the selection of those partners in August 2012. The first project aims to serve 900 youth over three years who are aging out of the juvenile justice system and expects to produce budget savings from reduced incarceration costs. The second project plans to house 400 chronically homeless individuals over a three-year period and expects to produce budget savings from reduced Medicaid spending.

New York State

In July 2012, New York State issued a procurement for an intermediary to help set up a pay-for-success project that will offer transitional employment services to adults released from state prisons. In September 2012, the state issued a request for information (RFI) seeking suggestions for additional projects.

Other State and Local Governments

In January 2013 the Harvard Kennedy School SIB Lab announced that it will be offering pro bono technical assistance to four additional state and local governments in the US. In total, 28 proposals were submitted from across the US. This high level of interest and the content of the proposals confirm that a great deal of preliminary work is already underway by state and local governments exploring this promising new approach.

Guide to Social Impact Bonds

The rest of this guide provides a step-by-step manual for state and local governments considering the pay-for-success/social impact bond approach. It explains how to assess whether social impact bonds are a good fit for achieving your organization's goals, select a suitable policy, navigate the analytical, financial, and structural aspects of the development process, create a robust contract, and oversee the implementation and monitoring phase.

Step-by-Step SIB Development Process

| 1. Determining whether SIBs are a Good Fit for Your Organization | | | | |
|--|--|---|------------------------------------|---|
| Enthusiasm and commitment among leadership | A realistic possibility of taking a successful initiative to scale | Alignment with other performance goals | Sufficient interest from investors | |
| 2. Selecting a Suitable Policy | | | | |
| Sources of initial ideas | | Criteria for filtering ideas | | |
| Internal government discussions | | Priority policies | | |
| Informal conversations | | Strong agency leadership | | |
| Lists of programs with successful program evaluations | | Potential for high net benefits | | |
| A formal "request for information" | | Technically feasible | | |
| 3. Navigating the Development Process | | | | |
| Data Analysis Tasks | | Financial Modeling Tasks | | Structural Tasks |
| Match administrative data sets | | Conduct a benefit-cost analysis | | Begin initial engagement with potential partners |
| Analyze historical baselines | | Build a model of payment schedule options | | Obtain authority from the legislature |
| Choose target population | | Develop a financial cash flow model for the project | | Undertake a procurement process to engage services of an intermediary |
| Analyze historical performance of specific providers | | | | Undertake a process to engage services of providers |
| Conduct analysis necessary to develop evaluation methodology | | | | Hire an independent evaluator |
| 4. Putting All the Pieces Together | | | | |
| Negotiate payment terms | Support the intermediary as it raises private capital | Develop operating procedures | Draft and execute contract | Establish plan for making decisions about scaling/ expanding |
| 5. Implementing and Monitoring | | | | |
| Monitoring and oversight | Field office support | | Evaluation support | |
| 6. Wrapping Up | | | | |
| Final determination of outcomes and payments | Interpreting the results | | Decision about follow-on contracts | |

1. Determining whether SIBs are a Good Fit for Your Organization

Social impact bonds can be powerful tools for improving government performance and ameliorating social problems. But experience so far suggests that constructing each SIB requires a sustained effort of at least nine months. Given the amount of staff resources required, it is only worth undertaking a SIB if it will have a significant impact.

Before deciding to move forward on a SIB initiative, you should consider whether the basic conditions required for success are in place:

Enthusiasm and commitment among leadership

Given the effort necessary to implement each pay for success contract, these projects are worth pursuing only by leadership teams willing to dedicate their time and energy to making it work. Significant coordination between government departments will be required, and the lead agency head needs to be a champion for the approach. Without enthusiasm in both the budget office and among the governor's, mayor's, or county executive's top policy advisers, it is hard to imagine a project coming to fruition.

A realistic possibility of taking a successful initiative to scale

In most cases, SIB projects will need to serve at least a few hundred individuals per year; otherwise it will be impossible to obtain enough statistical precision to judge whether the intervention was successful. But given the effort required, even this scale is unlikely to be sufficient to justify setting up a SIB. Rather, a SIB requires either a larger initial scale or a realistic vision for scaling up a successful SIB into a larger (e.g. state-wide) initiative.

Alignment with other performance goals

SIB projects can be a way to drive change as part of a broader performance agenda. For example, a SIB project that provides new preventive spending may also involve the development of systems for linking data across agencies in order to measure outcomes – systems that can be applied to existing spending as well.

Imagine a situation in which the political process has made it difficult to allocate spending based on performance. Demonstrating the benefits from doing so in a SIB project could break through the political obstacles and allow not just the incremental SIB spending to be performance-based but also allow for better allocation of base spending – spending that will often be much larger than the incremental SIB spending. These kinds of spill-over benefits to a broader reform agenda could make even a small SIB project worth doing.

Sufficient interest from investors

Given the amount of risk that private sector investors will be taking on, most initial SIBs will need at least some philanthropic backing. It is important to hold informal conversations with potential investors, both philanthropic and commercial, early in the development process to verify that there is sufficient investor interest and to form a judgment about the scale of financing that it is plausible to expect. Ensuring that this engagement happens early in the process will help avoid a situation in which a government completes all other elements of the development process only to discover that interest from investors is lacking and there is in fact insufficient financing available for the project to go ahead.

2. Selecting a Suitable Policy

Once you have decided that your organization has the capacity and desire to move forward, the next step is to select potential policy areas to target. Early movers have come up with their ideas for projects from four sources:

Internal government discussions

It generally takes two or three meetings spaced over a couple of weeks to develop a good list of 10 to 20 candidate projects. At the first meeting, the SIB concept is explained and questions about it are answered. Then participants are encouraged to think about questions such as:

- Are there places in your area of expertise where there is underinvestment in prevention?
- Are there promising programs that are currently under-funded or ready for scaling-up?
- Has your area experienced penny-wise but pound-foolish budget cuts?
- Are there important programs that get substantial funding but where there are serious concerns about performance?
- Are there promising programs or providers in other jurisdictions that we should try to bring to our city, county, or state?
- Do we have any proven programs with a long waitlist?

Informal conversations

Once it is known that a jurisdiction is considering the SIB approach, informal conversations with potential providers, intermediaries, and philanthropic partners can yield additional ideas. This initial outreach can help improve the quality and range of proposals submitted in response to procurement or information-gathering requests. During informal conversations, it is important to avoid any violations of procurement rules.

Lists of programs with successful program evaluations

Governments often review evidence from places such as the Coalition for Evidence-Based Policy’s “Social Programs that Work” list, the Washington State Institute for Public Policy cost effectiveness studies, and recent research results from the professional evaluation firms to see if there are proven programs in priority policy areas that could be replicated locally.

A formal “request for information” process

Both Massachusetts and New York State issued RFIs in an effort to collect suggestions for pay-for-success projects from the public. An RFI process offers the potential to learn about promising projects and programs that government officials may not be aware of. The process also offers an opportunity to begin to engage with organizations that may ultimately become provider and intermediary partners in a SIB project. An open process for gathering ideas about projects also provides benefits from greater transparency.

The next step is to narrow the list of potential projects to a set of serious candidates worthy of deeper analysis. Several criteria can help:

Priority policies

Above all, the policy must be in an area that is a top priority for the governor, mayor, or county executive. Establishing a pay-for-success contract takes sustained attention over the course of a year or more from top officials in the state or city implementing it. Given the other demands on these officials’ time, it is unlikely that an initiative will succeed unless it is directly aligned with one of the governor’s, mayor’s or chief executive’s top priorities.

Strong agency leadership

It is hard to imagine a project succeeding unless the lead agency for the project has leadership that is both effective and committed to the project.

Potential for high net benefits

These projects can work only if they produce a combination of social benefits and monetizable savings such that both taxpayers and investors come out ahead. This level of success requires a highly effective program model and a highly effective provider organization. Both are hard to find. Indeed, early projects are turning out to contain more innovation and learning and less replication than we originally anticipated, because rigorously proven models of preventive services do not yet exist for most of the highest priority policy areas of state and local governments.

Many potential projects get crossed off because the evidence fails to suggest that there will be sufficient benefits or because it appears unlikely that enough provider capacity can be created. At this stage in the process it is also worth clarifying with decision makers whether projects must have the potential to completely pay for themselves in monetizable budget savings or, alternatively, whether projects can be considered that partially pay for themselves while producing significant social benefits (e.g. reduced crime, higher wages, healthier children, etc.).

Technically feasible

For a policy to be a good fit for a SIB, it must also satisfy several more technical criteria:

Measureable outcomes

The information technology revolution is an important part of what makes the SIB model feasible. Results such as earnings, school test scores, recidivism, and health expenditures can now be assessed on an ongoing basis using government administrative data at a much lower cost than collecting data through a survey. Still, performance-based payments systems are appropriate only when available outcome measures are highly correlated with a program's comprehensive social net benefits.

When measures are only weakly correlated with program success or when only one component of a program's impact can be measured, performance

contracts based on the imperfect measure have the potential to distort performance toward that which can be measured.

Sufficient sample sizes

To be able to determine whether the outcome was produced by the intervention rather than by chance, there needs to be a sufficiently large number of people served – generally at least 200 per year. This rules out some preventive investments that are targeted at high cost populations that are very small.

Well-defined treatment population

The treatment population must be defined in such a way that avoids “cream-skimming” (selecting only the easiest-to-serve people). Typically, this will be accomplished by assigning a specific set of individuals to the service provider and holding the service provider accountable for the outcomes of all assigned individuals, regardless of whether the individuals show up to receive services.

Credible impact assessments

Estimating the impact of an intervention requires a comparison between the outcome that was achieved in the target population and the “counterfactual” outcome that would have occurred in the absence of the intervention.

A number of evaluation strategies can be employed to accomplish this, including a randomized controlled trial, a “regression discontinuity” design that compares outcomes of those just below and just above program eligibility thresholds, a “difference in differences” comparison of changes in outcomes in populations offered the service to similar ones that were not offered the service, or a “historical baseline” comparison to past outcomes for similar individuals. If there is no credible approach to establishing a counterfactual outcome for a particular intervention, then a SIB may not be feasible.

Safeguards against harming the treatment population

In the worst-case scenario, failure to achieve performance targets could lead the providers to cease operations, leaving the target population without services. For this reason SIBs work better for supplemental services than for core operations. It would be risky to use these performance contracts to fund the basic operations of charter schools, day care centers, or prisons.

Based on these criteria, there are several types of interventions that appear to be getting the most attention:

- Projects that aim to reduce recidivism among those being released from prison or jail.
- Services for at-risk youth such as those aging out of the foster care and juvenile justice systems.
- Homelessness prevention.
- Pre-natal, early childhood, and pre-school services.
- Preventive health care interventions for asthma or diabetes.
- Home-based services designed to keeping elders out of nursing homes.
- Employment/work-force development services.

3. Navigating the Development Process

Once a policy has been selected, a series of data analysis, financial modeling, and procurement/project structuring tasks need to occur.

Data Analysis Tasks

Match administrative data sets

For most SIB projects, outcomes will be measured through a match of datasets that reside in multiple agencies. For example, the list of individuals released from prison may be matched to data on subsequent convictions and sentences as well as to earnings records from the state unemployment insurance system. Or a list of homeless individuals will be matched to Medicaid records to determine health system savings.

Accomplishing this requires agency lawyers to establish any needed memos of understanding, and it also requires IT analytic staff to do the matching. In some cases, it may be necessary to hire outside data consultants to help with the matching process. Local universities might also be able to help provide technical assistance.

Analyze historical baselines

In order to determine the potential benefits from improved outcomes, it is necessary to establish what current outcomes are for the target population. Because SIB projects will often focus on producing outcomes that are measured two to five years after services begin, the historical baseline needs to be established by analyzing data for cohorts that can be observed for a similar time frame. For example, to establish a baseline for 5-year recidivism rates, one would analyze data from a cohort released in 2008 to see what their recidivism pattern was between 2008 and 2013. At this stage it is also necessary to make preliminary decisions about what the outcomes are that the initiative aims to improve and exactly how they will be measured.

Choose target population

Further analysis needs to be done to determine how many individuals are available to be served in the targeted geographic region (or alternatively how broad a geographic region is needed to obtain the desired population size). This analysis will also inform decisions about whether to focus services on high-cost sub-populations, such as ex-offenders whose risk scores predict the highest probability of reoffending or homeless individuals who have had the highest usage of health care resources. In many cases a project's economics will work only for these high cost sub-populations, so it is critical that there be a sufficient number of such individuals.

Analyze historical performance of specific providers

Once a provider (or set of providers) is selected, it will often be useful to match their lists of clients served in the past to the state administrative records that are going to be used to measure outcomes to determine whether assumptions about the provider's effectiveness are plausible. In most cases, there will not be a way to come up with a sufficiently good comparison group to perform a rigorous historical impact evaluation. Nonetheless, demonstrating that the provider has in the past achieved results similar to what is anticipated in the project will be important in recruiting investors.

Conduct analysis necessary to develop an evaluation methodology

Depending on the evaluation approach, a series of technical analyses will need to be conducted to finalize the methodology. Under any approach, it will be necessary to assess how precisely outcomes can be measured at the intended sample sizes and the extent to which controlling for covariates can reduce that variability. If results will be compared to a historical baseline, it will be desirable to establish that that baseline has been stable over time. If a difference-in-differences approach will be used, it will be important to show that treatment group and comparison group outcomes have moved in parallel in the past. If a regression discontinuity approach will be used, it will be necessary to establish that a sufficient fraction of the population lies near eligibility thresholds.

Financial Modeling Tasks

Conduct a benefit-cost analysis

A detailed analysis of the costs and benefits of the project is required to confirm whether the proposed social impact bond makes sense for the government. This analysis also informs decisions about how much to pay at different levels of performance since governments will generally want payments to be no greater than the benefits produced. In conducting this analysis, it is important to distinguish between benefits that produce monetizable budget savings and those that don't, since decision makers will generally want to know both whether the total social benefits exceed costs and also the extent to which the project could "pay for itself."

It is also useful to disaggregate budget savings by level of government (federal, state, local), since in some cases decision makers may want to treat savings accruing to their own level of government differently. Decisions need to be made about whether to count only benefits that can be observed in the short term or whether to also extrapolate to longer-term benefits. Ensuring that potential budget savings are actually realized may require conversations with departments about reducing their budgets in the future if a successful project reduces the population in need of the departments' services.

Build a model of payment schedule options

Payment schedules will generally have several features. First, there will be no payments until a minimum performance threshold is reached. Second, there will be a range where payments increase with better performance. Third, because budgetary authority for making performance payments is capped, there will be a point at which the maximum payment is reached and above which payments no longer rise with performance. In preparing for negotiations with private sector partners, it is useful to augment the payment schedule model with a probability distribution of outcomes in order to understand how the expected payment to investors varies under different payment schedules.

Develop a financial cash flow model for the project

Ultimately, it is necessary to build a model of project cash flows incorporating the number of people to be served each year and the cost of that service, the timing of the investor payments that finance service provision, and the timing of government performance payments. Governments will generally want to insist that the full funding commitment necessary to provide service for the duration of the project be in place at the beginning, so that there is no risk that the project will be shut down mid-stream because of lack of funds.

While it will often be appropriate to make interim performance-based payments before the end of the project, to avoid shut down risk in the event that early performance targets are not met, these interim payments should not be used to finance service provision. Social impact bond projects should be designed with a long enough duration of services to allow for learning and mid-course corrections to occur. In addition, to facilitate decision-making about continuing or expanding the project, it is important to allow a large enough sample size to accrue for outcomes to be measured with sufficient precision. From this perspective, the six-year duration of the original Peterborough project is a good model.

Structural Tasks

Begin initial engagement with potential partners

Given the novelty of the pay for success approach, it is important to engage potential partner organizations early in the project planning process. Finding an early opportunity to explain the model and the motivation behind it to the provider community, perhaps through a public meeting to answer questions about the RFI or RFP, is a worthwhile endeavor. This can help alleviate anxiety about the concept and also helps the government agency understand the local landscape of innovative service providers and/or intermediaries.

Obtain authority from the legislature

In most governments, appropriated funds must be spent within the current fiscal year. Pay-for-success contracts span several years and governments need a mechanism to commit to making the success-based payments in the future. The specific mechanism to accomplish this will vary.

In Massachusetts, legislation was enacted that gives the Secretary of Administration and Finance the authority to enter into up to \$50 million in pay for success contracts backed by the “full faith and credit” of the Commonwealth. In addition, the legislation establishes a sinking fund and requires the Secretary to request appropriations in each year equal to the maximum performance payments that may ultimately be needed based upon the services delivered in that year. This helps ensure that funds are available when performance payments are due, and avoids the need for large one-time appropriations in payment years.

Undertake a procurement process to engage services of an intermediary

Given the amount of scrutiny social impact bond projects will receive, there is a strong case for using an open and transparent procurement process for selecting partners. Model RFRs are available from the Massachusetts and New York State procurements.

Undertake a process to engage services of providers

So far governments appear to be choosing one of two paths in identifying service providers. The first path is to do a separate procurement for service providers. The second is to delegate the task of identifying and contracting with service providers to the intermediary – essentially in a subcontract relationship.

Hire an independent evaluator

An independent evaluator is required to validate the results of the project. The evaluator needs to be independent of both the government and of the intermediary/service providers.

4. Putting All the Pieces Together

Negotiate payment terms

Thorough preparation enables the government agency to enter into negotiations with the partner organizations and to finalize the terms of the contract. The contract specifies how and when payments will be made, provides an explanation of how the parties will work together, and most crucially, spells out how the performance of the intervention will be assessed.

Support the intermediary as it raises private capital

The intermediary will need to be able to share data on historical performance baselines and on the service provider's track record with potential investors in order to convince investors that the project has the potential to achieve its target outcomes. More generally, potential investors will need to be assured of the government's commitment to the project.

Develop operating procedures

During this stage, operational details need to be worked out and tested. How will the sample members be identified? How will the handoff to the service provider occur? How will individuals in the treatment and control groups be tracked for evaluation purposes?

Draft and execute contract

A well-constructed contract helps guarantee transparency and cooperation between parties and safeguards the population being served. For example, language should be included to guarantee that services are delivered for the full period intended, establish a dispute resolution process to settle any disputes that may arise, and clarify situations in which the contract may be terminated.

It seems likely that model language will start to emerge after the first few U.S. contracts are completed, but at the moment the contracting process is requiring a large amount of original legal work.

Establish a plan for making decisions about scaling/expanding

It is important that a plan be in place at the beginning of implementation about how and when decisions will be made about continuing and expanding the project. For example, if an initial contract specifies that six years of services will be provided, then it would make sense to make a decision about extending the project by the end of the fifth year in order to allow a year to assemble the follow-on project. It would be a mistake to wait until the project is complete to make these decisions as this would shut down operations for a period while a new contract is negotiated and then require starting them up again.

5. Implementing and Monitoring

Once the project has been launched, most of the responsibility for day-to-day operations will be handled by the service provider, with assistance and direction from the intermediary. However, the government will need to staff three important functions:

Monitoring and oversight

There will need to be a government project manager who tracks the performance of the private sector partners, trouble shoots unforeseen problems, oversees disbursements as performance targets are achieved, and participates in regular meetings of the coordinating council made up of representatives of the service provider, intermediary, and government. We anticipate that this function will require between 0.33 and 0.50 FTEs per project, so a single individual could perform this function for two or three SIBs.

Field office support

If the program model requires the government to refer program participants to the service provider (e.g. pre-release staff in a prison may need to refer about-to-be-released offenders to a job training program), there will need to be attention paid to carrying out this role effectively. In some cases there will need to be additional staff resources assigned. In other cases, existing staff may be able to carry out this function.

Evaluation support

Depending on the evaluation design, a government employee (or evaluation contractor) may be needed to identify individuals eligible for service on a weekly or monthly basis (e.g. those recently released from prison), randomize to select the ones to be served, keep track of which individuals were assigned to the treatment group and which individuals to the control group, and give the service provider the list of treatment group individuals to serve. This same individual could be responsible for obtaining the administrative data outcomes for sample members and producing regular (e.g. quarterly) outcome reports. We anticipate that this function will require approximately 0.50 FTEs per project.

6. Wrapping Up

As the project nears its conclusion, three important functions need to be performed:

Final determination of outcomes and payments

Once the outcomes have been assessed and verified, success payments will be calculated and released by government. The credibility of the social impact bond approach hinges on being able to demonstrate to taxpayers that their dollars were spent only to pay for outcomes that were actually achieved. Maintaining credibility therefore requires a rigorous evaluation methodology, transparency about results, and an independent evaluator, validator, or auditor to certify the results.

Interpreting the results

Social impact bonds are designed to promote innovation in addressing social problems. Innovation is inherently risky, and some projects will fail to achieve performance targets, leading to investor losses and the non renewal of the program. It is important that governments communicate the failure risk from the start, for example by setting a goal that two out of three SIB projects should succeed. Moreover, if a project fails to achieve performance goals, it will be important to remind people that while the intervention failed, the SIB model actually succeeded, in that it protected taxpayers by shifting the failure risk to investors and by avoiding an open-ended funding commitment for an unsuccessful program.

A more complicated communications challenge could arise if a project sets overly ambitious performance targets. Consider a scenario in which all of the partners in a SIB project decide to target a 50 percent reduction in a social ill even though a 25 percent reduction would represent an unprecedented achievement. If the project delivers a 25 percent reduction and investors end up losing most or all of their investment, the project is likely to be interpreted as a failure. This consideration suggests that payment schedules should be designed to make significant partial payments at levels of performance that the partners in the SIB project believe should be interpreted as a “partial success” rather than as a failure.

Decision about follow-on contracts

Should the intervention prove successful, the government agency will need to decide whether to continue with a follow-on SIB contract or to shift to a more conventional funding approach. A follow-on SIB contract has the advantage of maintaining the performance focus, but the disadvantage of continuing to share benefits with investors. Decisions about follow-on contracts should be made at least one year before the end of the service delivery period of the initial project to avoid gaps in service.



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The Harvard Kennedy School Social Impact Bond Technical Assistance Lab (SIB Lab) conducts research on how governments can foster social innovation and improve the results they obtain with their social spending. An important part of our research model involves providing pro bono technical assistance to state and local governments implementing pay-for-success contracts using social impact bonds.

Through this hands-on involvement, we gain insights into the barriers that governments face and the solutions that can overcome these barriers. These insights are ultimately published in academic papers and policy briefs. By engaging current students and recent graduates in this effort, we are able to provide experiential learning as well.

The SIB Lab is located within the Taubman Center for State and Local Government at the Harvard Kennedy School. The director of the SIB Lab is Professor Jeffrey Liebman.

For more information about social impact bonds or our work, please visit our website: hks-siblab.org.

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