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# Pay for Success Contracting: The Emerging Paradigm

by Joseph Coletti  
Project Director: Leonard Gilroy



# Reason Foundation



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## Part 1

# Introduction

Pay for Success (PFS) contracts provide a way for governments to test human service programs through the private sector and only pay if the program delivers on its promised results. Although they have been in existence for just five years, PFS contracts have generated a great deal of interest around the world in that short time. There are now more than 50 PFS contracts underway or completed globally, with 11 in the United States.

Readers may recognize PFS contracts as Social Impact Bonds, or SIBs, the term used to describe these contracts when first developed in the United Kingdom. Because the government does not take on debt, however, this paper uses the term “PFS contract.” Although this can create confusion with other methods governments use to pay only for success based on data and evidence, the term PFS contract is an emerging standard for these specific transactions.

At its core, a PFS contract is a type of public-private partnership for social services. Governments have often contracted with private vendors to build or manage capital projects from courthouses and prisons to parking garages and toll roads. Governments have also contracted with private providers of amenities, such as garbage collection. Unlike with capital projects and basic amenities, users of social services are not the payers, which removes prices as a mechanism to gauge success, particularly since benefits may not accrue to the same agency budget in the same fiscal period as the costs.

PFS contracts represent the latest attempt by governments to stop paying for individual programs, as opposed to entire agencies or fundamentally misguided policies, that do not work. With 10% of federal programs having any evaluations, and few of those showing positive results, there is a clear opportunity to find and stop wasted spending. Limited government advocates have been more likely to view PFS contracts as potential vehicles to create new avenues of government spending without reducing government elsewhere or acknowledging the cost.

Originally premised on saving governments enough money on other programs for them to pay investors back their capital with a premium, more recent approaches have explored ways to value projects based on a combination of hard savings, social benefit, and public willingness to pay. South

Carolina's recent PFS contract is an example of the role private philanthropies can play because they do not require a monetary return.

As more PFS contracts start and conclude, elected officials and government employees will have more case studies and data available to guide their decisions. Current experiments and explorations have already yielded a number of valuable lessons to guide future efforts. The real hope is to apply the lessons and methods of accountability from these small programs—the largest of which anywhere is a Massachusetts contract with an investment of \$27 million over seven years—to more government spending.

This paper is intended as a primer for policymakers on the emerging paradigm of PFS contracting. The first section describes how PFS contracts work, section two provides a brief history of their development, section three considers the rationale for these contracts, section four describes a three-part valuation method, section five considers challenges, section six looks at some examples, section seven at lessons, and section eight has concluding thoughts.

## Part 2

# What Is Pay for Success (PFS) Contracting?

What if government only paid for programs that deliver results? That is the long-standing question driving interest in Pay for Success (PFS) contracts, which we will use interchangeably with the term Social Impact Bonds (SIBs).<sup>1</sup>

At its core, a PFS contract is a financing mechanism for performance-based contracts focused on human services. Instead of paying for a service and hoping for outcomes, the government makes deferred payments for specific social outcomes, such as lower prison recidivism, improved educational outcomes, resident-paid housing, and higher levels of employment in a community. Private investors pay the program's cost until an independent evaluator verifies the promised results—for example, three years in the UK's recidivism reduction contract and one year in a Utah pre-kindergarten expansion—at which point the government pays back the investors according to the contract terms if successful. The payment may include a performance bonus if certain performance thresholds are achieved. If a PFS program is not successful, private investors bear the cost without government assistance.

The United Kingdom signed its first PFS contract in 2010 to lower recidivism at HM Prison Peterborough outside of London. There are now 50 active or completed PFS/SIB projects worldwide, including 11 in the United States. More than 70 additional state and local governments in the U.S. have formally explored the concept.

PFS contracts apply risk-sharing and private financing concepts from public-private partnerships (P3s) and performance-based contracts to social outcomes. P3s have long been used to finance long-term government needs such as facilities and infrastructure, including toll roads, courthouses and water systems. Governments have outsourced management and maintenance services to for-profit firms, and have used recurring grants to local nonprofits that provide health or other human services, though these grants and contracts are not strictly tied to service levels.

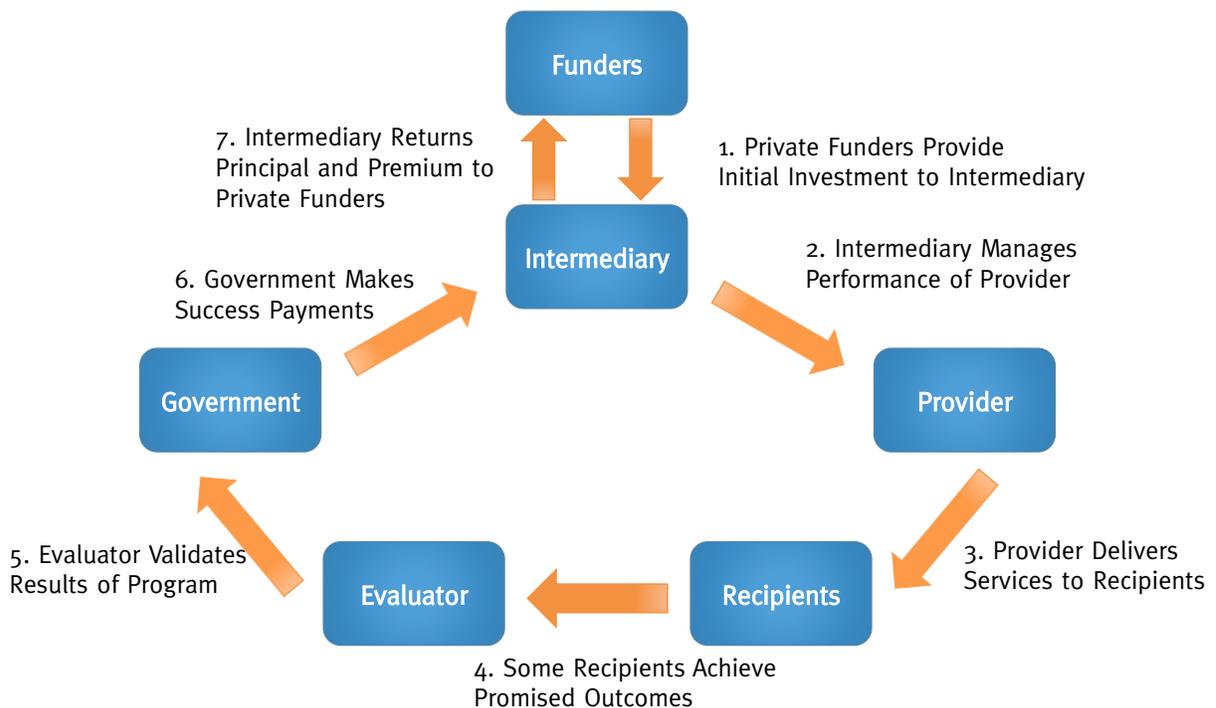
What truly sets PFS contracts apart for government is the number of parties involved. The **government's** main contact is with an **intermediary** who coordinates among the **investors** and **service providers**, and may also be active in those roles itself. All parties must then agree on the

desired outcomes, how to measure those outcomes, and an independent **evaluator** who will determine whether the intervention reached its goals. Figure 1 shows a diagram of this structure.

Adding to the degree of difficulty government faces in these contracts is the number of variables in play and the incentives for each group. PFS contracts have an inherent tension between evidence and experimentation. They offer a way to experiment with evidence-based interventions in new settings or at a larger scale. Flexible implementation can create uncertainty for the evaluator and government, as it can be difficult to know why the intervention worked or failed, but this flexibility is also an advantage of PFS contracts compared to the typical government program. The PFS contract can leave operational decisions with the private provider who actually delivers the service instead of mandating a specific approach regardless of circumstances.

Despite the challenges, the idea of governments evaluating program results, ending those that fail, only paying for success, and offloading the financial risk onto willing investors and the operational risk onto service providers is compelling. This paper will provide readers a history of PFS contracting, reasons for government to enter a PFS contract, a framework for valuing a contract, challenges in planning and implementation, a review of contracts that have reached evaluation and payment, and lessons to apply to future contracts.

**Figure 1: Typical Structure of a Pay for Success Contract**



## Part 3

# The Emergence of Pay for Success Contracting

Pay for Success contracts got their start in the United Kingdom, where they were called Social Impact Bonds (SIBs), a name that still sticks and causes confusion. Prime Minister Tony Blair and Finance Minister Gordon Brown—along with the pioneering financial advisory nonprofit Social Finance—began to develop the financing mechanism in 2007. The first project in 2010 focused on inmates with short sentences at HM Prison Peterborough, outside London. By the end of 2012, the UK had 13 more SIB projects underway, mostly in employment and education.

The Center for American Progress introduced the concept to policy circles in the United States with a report from Harvard professor Jeffrey Liebman in 2011.<sup>2</sup> New York City and the Commonwealth of Massachusetts quickly became early adopters in the U.S. They each launched projects in summer 2012 focused on prisoner rehabilitation; Massachusetts also pursued PFS for a mental health and housing initiative. In New York City's case, Mayor Michael Bloomberg tapped his private foundation to guarantee payments for the financial firms involved, led by Goldman Sachs.

While some center-right and center-left policy experts balked, more organizations and governments explored PFS options. George Overholser and Christine Whistler founded the nonprofit financial advisory firm, Third Sector Capital Partners in 2010, and Social Finance opened a U.S. office in 2011. The Pritzker Foundation bankrolled an effort in Utah to expand pre-kindergarten programs. The Duke Endowment offered to South Carolina Gov. Nikki Haley that it would forgo a return on its investment in Nurse Family Partnership expansion so the state could use those funds to continue and expand the program. Liebman created the SIBLab (now the Government Performance Lab), which offered technical assistance to early adopter states, at the Harvard Kennedy School.

Excitement continued to grow as money flowed from foundations and the federal government, and more state and local governments explored programs with the potential to meet the criteria for PFS contracts. The federal government created a Social Innovation Fund, which provided more grants through organizations such as the Institute for Child Success, Third Sector Capital, the Urban Institute, and the Nonprofit Finance Fund. Financial firms such as Bank of America are interested

for their own investment and on behalf of their clients. Accenture, Deloitte, IBM and other traditional consulting firms began to offer their services to governments. Despite the interest, however, there were still few contracts as governments waited for others to go first and for results from existing projects.

Results first started to be seen in 2015. The UK and New York City ended criminal justice PFS initiatives at HM Prison Peterborough and Rikers Island. The Peterborough project fell short of its first payment benchmark, but could still meet its next benchmark and receive payment. Further work has stopped on this contract as many of the activities have been subsumed into a broader national effort. New York canceled the Rikers Island project for failing to meet its objectives, leaving Bloomberg Philanthropies to cover \$6 million of Goldman Sachs' \$7.2 million investment. Three education and employment projects in the UK were renewed, though the actual results were not made public. Utah declared its pre-kindergarten program successful, but *The New York Times* and others soon challenged the validity of the success metrics and some key project design assumptions.<sup>3</sup> In New South Wales, Australia, two projects' promised annual payouts to investors had better returns than anticipated in their first year.<sup>4</sup> (See Section 6 for more details on these projects.)

Santa Clara County, California, was the only government to conclude a PFS contract in 2015, but South Carolina and Connecticut entered PFS contracts in early 2016. Other state and local governments took steps to make possible future PFS contracts:

- Massachusetts and Utah sought information in specific policy areas.
- North Carolina and Pennsylvania issued general requests for information and made the responses publicly available online.
- Pennsylvania followed up with a request for proposals in August, the same month Oklahoma also issued one.
- Salt Lake County sought proposals in homelessness, criminal justice, and child and maternal health.
- Colorado and Texas passed legislation authorizing PFS contracts and setting rules on how the government could undertake them, including how to appropriate funds for the projects.<sup>5</sup>

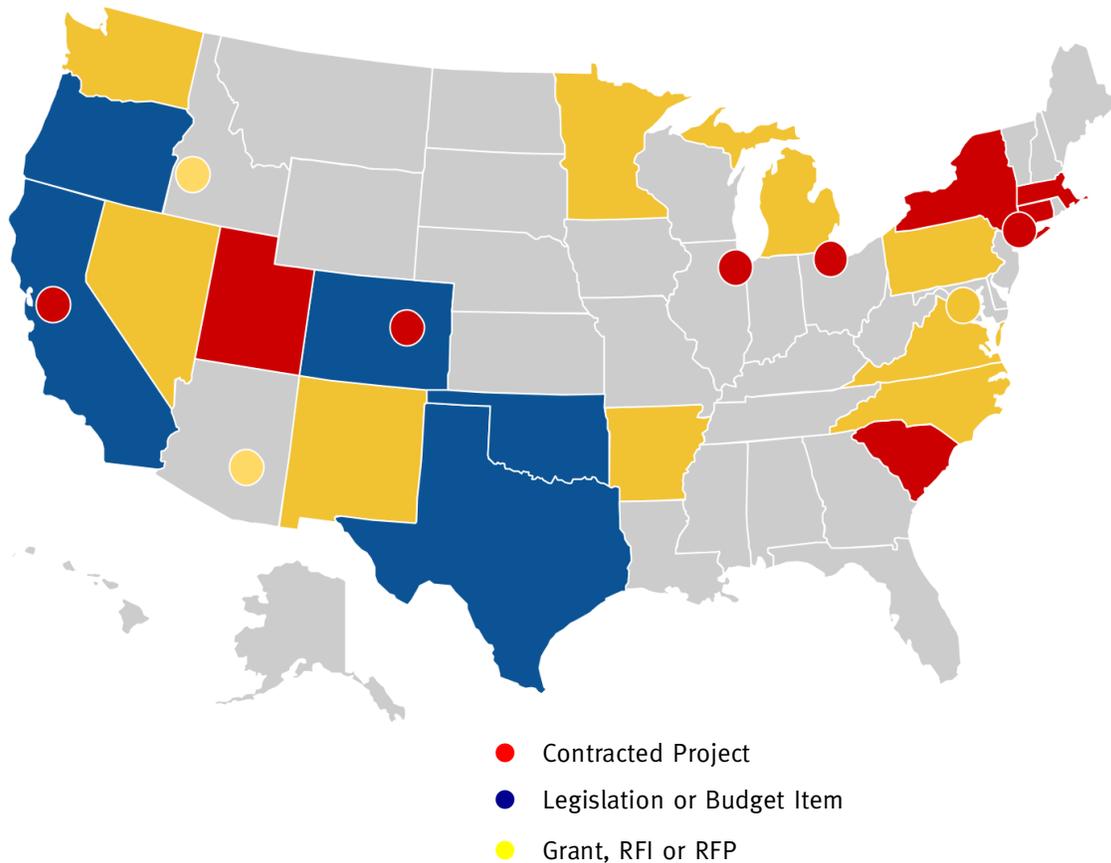
Third Sector Capital Partners developed the concept of a Social Impact Guarantee (SIG), in which the government pays the money from the start, but private investors pay back the government's investment if the project does not meet its objectives. It claims that two states will implement this new variety of PFS contract by the end of 2016.<sup>6</sup> Even with new projects and legislation, there are still significant debates on when PFS contracts make sense, how to set benchmarks, how to identify and quantify savings, how to adapt and localize proven successes from one jurisdiction to another, and how to apply lessons to other government contracts.

**Table 1: U.S. Activity on Pay for Success Contracts**

| Contracted Projects        |  |  |   |
|----------------------------|--|--|---|
| Year                       | Contract   | Amount   | Focus Area  |
| 2012                       | New York City ABLE Project for Incarcerated Youth                        | \$9.6 million  | Criminal Justice:<br>Reduce recidivism bed days 10%   |
| 2013                       | Utah High Quality Preschool Program                                      | \$7.0 million  | Education:<br>Reduce need for special education in kindergarten   |
| 2013                       | New York State Increasing Employment and Improving Public Safety         | \$14.7 million   | Criminal Justice:<br>Reduce recidivism, increase employment one year after release, and maximize participation in transitional jobs   |
| 2014                       | Massachusetts Juvenile Justice Pay for Success Initiative                | \$16.1 million   | Criminal Justice:<br>Reduce recidivism, increase job readiness, and increase employment   |
| 2014                       | Chicago Child-Parent Center Pay for Success Initiative                   | \$16.9 million   | Families and Children:<br>Increase kindergarten readiness and third-grade literacy, reduce special education  |
| 2014                       | Cuyahoga (Ohio) Partnering for Family Success Program                    | \$4.0 million  | Families and Children:<br>Reduce foster care out-of-home placement days 25%   |
| 2014                       | Massachusetts Chronic Individual Homelessness Pay for Success Initiative | \$24.5 million   | Housing:<br>Achieve stable supportive housing for one year  |
| 2015                       | Santa Clara County Project Welcome Home                                  | \$6.9 million  | Housing:<br>Achieve continuous stable tenancy for 80% of participants for 12 months   |
| 2016                       | Denver Permanent Supportive Housing                                      | \$8.6 million  | Housing:<br>Achieve 365 days of stable housing, reduce jail bed days 20%  |
| 2016                       | South Carolina Nurse-Family Partnership Pay for Success Project          | \$13.0 million   | Families and Children:<br>Reduce preterm births and hospital visits due to injury, increase healthy spacing between births and number of moms served in specific high-poverty areas                         |
| 2016                       | Connecticut Family Stability Pay for Success Project                     | \$6.9 million  | Families and Children: Reduce foster care out-of-home placements, reduce child re-referrals to the Department of Children and Families, reduce substance use, and increase Family-Based Recovery enrollment |
| Legislation or Budget Item |  |  |   |
| Year                       | State  | Description  |   |
| 2014                       | California   | California Assembly Bill 1837 approved, enacting Social Innovation Financing Program |   |
| 2014                       | Oklahoma   | Oklahoma SB 1278 signed into law   |   |
| 2014                       | Oregon   | \$800,000 to Center for Evidence-Based Policy at OHSU for a Pay for Prevention pilot |   |
| 2015                       | Colorado   | Colorado HB 15-1317 signed into law allowing Pay for Success contracts               |   |
| 2015                       | Texas  | Texas HB 3014 signed into law allowing Pay for Success contracts                     |   |

| Grants, RFIs and RFPs |   |   |
|-----------------------|---|---|
| Year                  | Entity  | Action  |
| 2012                  | Minnesota   | Requests for Proposal (RFPs)  |
| 2013<br>2014<br>2015  | Michigan  | Request for Information (RFI), RFP, grants and assistance from Corporation for Supportive Housing (CSH) & SIB Lab |
| 2013<br>2015          | Colorado  | Grants and assistance from SIB Lab, University of Utah  |
| 2013<br>2015          | Washington, D.C.  | RFP for feasibility study, assistance from SIB Lab  |
| 2014                  | Pima County, Arizona  | RFP for feasibility study   |
| 2014<br>2015          | Nevada  | RFI, Grant from University of Utah  |
| 2015                  | Boise, Idaho  | Grant from University of Utah   |
| 2015                  | Montana   | Grant from University of Utah   |
| 2015                  | New Mexico  | Grants from CSH and SIB Lab   |
| 2015                  | North Carolina  | Grant from Institute for Child Success, RFI   |
| 2015                  | Pennsylvania  | RFI, RFP, assistance from SIB Lab   |
| 2015                  | Virginia  | Grant from Third Sector   |
| 2015                  | NGOs in New Jersey, Tennessee and Washington received planning grants |   |

### Pay for Success Activity



Source: Author created, based on data from [payforsuccess.org](http://payforsuccess.org), Brookings Institution

## Part 4

# The Role and Rationale for Pay for Success Contracting

It is easy to see the appeal to governments of PFS contracting. They can adopt or expand programs that have performed well, delay payment for preventive programs until they reap savings from avoided treatments, and pass the initial cost and risk to the private sector. Given the cost of treating social ills from homelessness to substance abuse, prevention is more fiscally prudent, but it is hard to divert money from treatment of existing problems to prevent future problems. Tracy Palandjian, one of the founders of Social Finance US, has touted the potential for PFS contracts to “monetize prevention.”<sup>7</sup>

Avoided payments are the clear benchmark in Utah’s preschool expansion, which aims to reduce the number of special education interventions in elementary school. Inmate-focused programs in the UK and New York City spent money first on preventive measures to reduce recidivism, with the goal of reducing the prison population later. British education and employment efforts sought savings from avoided government assistance enrollment. Assisted housing programs seek to keep people from mental health treatment and incarceration.

John Bridgeland, director of the White House Domestic Policy Council under President George W. Bush, and Peter Orszag, former director of the Office of Management and Budget under President Barack Obama and the Congressional Budget Office, estimate that “less than \$1 out of every \$100 of [federal] government spending is backed by even the most basic evidence that the money is being spent wisely.” Of those that have been studied in a way to draw reasonable conclusions, they add, a majority have not proven to have benefits that exceed their costs.<sup>8</sup> Some, such as Scared Straight, a program that takes children inside prisons to deter them from crime, actually make the problem worse.<sup>9</sup> Unfortunately, there is no overall compilation of which government programs work and which do not, due to lack of evidence. Advocates for PFS contracting talk about innovation through evidence, but strictly speaking, evidence-based programs are not, by definition, innovative. Rather, these programs have been researched and found to provide results, which is preferable to the status quo of unevaluated programs. The innovation comes from expanding the programs to cover new

populations or adopting the programs in new places. It requires balancing fidelity to proven methods and adaptation to different circumstances.

As government resources get stretched thinner, career employees, political appointees and elected officials feel increasing pressure to deliver with the dollars that are available. Turnover in governments over the past decade has also helped shake up traditional government relationships. A typical reaction to the idea that government can, for the first time, pay only for services that achieve their promised outcomes is, “How do we pay for services now?”

Consistent with Bridgeland and Orszag’s findings at the federal level, over the last 20 years the Washington State Institute for Public Policy (WSIPP) has examined 582 state and local programs in criminal justice, child welfare, education, numerous health issues, and workforce development—a small fraction of all the initiatives being tried in each area—and found three-fifths had either no cost-benefit results or higher costs than societal benefits.<sup>10</sup> Given the small share of validated successes among all government programs, it actually can be considered innovative to base policy decisions on something besides good intentions and anecdotes, which has led to the interest in PFS and in the Pew-MacArthur Results First Initiative of the Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation, which seeks to expand the WSIPP model to other states.<sup>11</sup>

## A. Why Are Investors Interested?

Philanthropists and others in the nonprofit sector have long seen a symbiotic relationship between private charity and government spending. “Philanthropy develops the idea, government scales the idea, and nonprofits implement the idea,” is how Robert T. Grimm, Jr., director of the Center for Philanthropy and Nonprofit Leadership at the University of Maryland’s School of Public Policy, described this relationship.<sup>12</sup> PFS contracts update that traditional mix of roles with greater collaboration across all three areas, but with the same underlying premise of using government funds to expand or replicate proven programs.

Investors may see a way to earn a financial return while doing good for others. Philanthropists may see a way to jumpstart programs or validate their work plan. Nonprofit providers may see government involvement as necessary to their survival. South Carolina’s, however, is the first PFS in which there is no possibility for government financing to do more than supplement the private investment through the life of the contract. This approach requires understanding the differing motivations of participants and a willingness to go without investors seeking to earn back their capital plus a return.

Philanthropies such as the Duke Endowment, the Laura and John Arnold Foundation, the Pritzker Foundation, and Bloomberg Philanthropies will determine how financially viable future contracts can be. The Duke Endowment has stated its willingness to forgo payment so governments can reinvest in successful programs. Pritzker provided an upfront guarantee before the state of Utah agreed to pay for its preschool expansion. Bloomberg not only paid \$6 million to Goldman Sachs after the Rikers Island project was canceled, it is also spending \$42 million on a What Works Cities initiative that includes a focus on “new contracting strategies.”<sup>13</sup> The Arnold Foundation has provided \$7.4 million to the Harvard Government Performance Lab, which grew out of the Social Impact Bond Lab (SIBLab) that has provided technical assistance to governments exploring PFS contracts.

## Part 5

# Understanding the Benefits of a Pay for Success Contract

Pay for Success advocates first sold the contracts as a way to pay for new, effective programs from the savings as other services are used less. For example, a successful program for prisoners re-entering society can reduce recidivism, which can save \$4,000 or more per person per year. The lower spending on returning prisoners would more than offset the cost of a pre-release intervention. Government could cash in its savings to provide investors a return on their initial funding, and to pay for continuing the new program on its own.

Cashable savings have been harder to find in PFS implementations than originally expected, however, which has led to a proposed three-part measure of relative benefit that combines cashable savings, societal benefit and willingness to pay.<sup>14</sup>

### A. Cashable Savings

In a PFS contract, some portion of the target population was going to have a positive outcome regardless of the intervention, so the savings can only come from the newly added people. Hence, some portion of current programmatic costs are likely to continue even with a reduction achieved through implementation of a PFS contract. For example, until a PFS intervention reaches a sufficient scale (e.g., widespread adoption throughout a system), a hospital likely would not be able to simply close its emergency department, a school would not be able to stop all its work with exceptional children, and an entire prison would not be able to close.

For example, suppose a substance abuse treatment center asked a state to calculate its success payment in a PFS contract based on 80% of participants not returning to prison. Using North Carolina costs as an estimate, the nonprofit and its investors would, in theory, save the state \$5 million per year in incarceration costs if 250 people went through the program in a year, assuming an annual \$25,000 cost per incarcerated inmate multiplied by 200 (80% of the 250 participants). But that is only part of the equation.

Somewhere between 50% to 75% of prisoners already manage to avoid returning to prison after they are released, meaning the net change, if the program reaches its target 80% non-return rate, would actually be between 5% and 30% of participants.<sup>15</sup> The state would likely not be able to close an entire prison in any event, which means the proper comparison would not be the \$25,000 annual cost per incarcerated inmate, but the \$4,000 annualized “daily cost” of food, linens, and other incremental costs for an additional prisoner, known more generally as the marginal cost.<sup>16</sup>

Therefore, in changing the way the “cost” is defined to account for ongoing programmatic costs, the impact of recidivism reduction on the cost of incarceration would shrink the calculated annual savings from \$5 million for 250 participants to between \$50,000 and \$300,000 for those same 250 participants.

## B. Societal Benefit

A program may not be able to generate enough savings quickly enough to pay for itself, but may still have the potential to make a positive long-term or collateral impact on government finances. In the case of the substance abuse program, maybe it could replace other residential facilities in addition to reducing the number of people who return to prison. In addition, the family of a former inmate who remains out of prison is less likely to need other government services. Those savings would not have accrued during the trial phase, but could be calculated from the future.

Program benefits may be better outcomes for society without any government savings or benefits that accrue to other levels of government. The savings to other governments is a challenging question, and has delayed implementation of Pay for Success contracts aimed at reducing Medicaid expenditures as states debate cost-sharing with the federal Department of Health and Human Services.

State governments may be more willing to pay for a program that provides local savings without directly seeking compensation. Local governments are creatures of state government and are more flexible than the federal government, so benefits can be captured in other ways. Benefits, in any event, should exceed costs for any government program, and Pay for Success contracts provide an opportunity to ensure they do before government pays. The value of that social benefit should be a consideration when considering what to pay in a contract.

North Carolina sought to describe some of this value in a Request for Information on PFS contracts the state issued in 2015.<sup>17</sup> It asked for projects that could cover their own operating costs if they had assistance on their initial capital investment. A residential facility could be such a project. North Carolina also asked for ideas that could provide research and evidence on an existing government program against a baseline of no intervention or a privately funded alternative. These would have worked like options: the investors would seek to recover the evaluation cost, and could earn a return

if the state ended the program, based on what the state would have spent to continue the ineffective program.

### C. Willingness to Pay

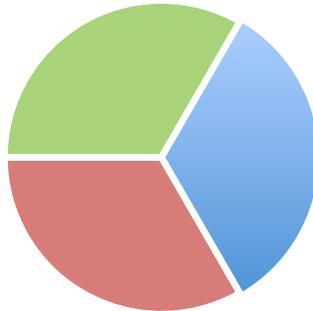
Some objectives command a premium. The quantifiable benefit of school choice or police body cameras may not be as high as the political demand for such changes. Such priorities may increase the benefit of some potential contracts, and should be a consideration when assessing the relative benefits of a contract. The balance among each of these factors will vary across projects. Jitinder Kohli, et al., provide some examples of how the three factors could work together in different programs.<sup>18</sup>

**Figure 2: Examples of How to Assess the Relative Benefits of a PFS Contract**

**Assessing the Relative Benefits of a Generic PFS Contract**

**Willingness to Pay:** Is it worth spending new money or reallocating money from existing programs to help achieve this outcome?

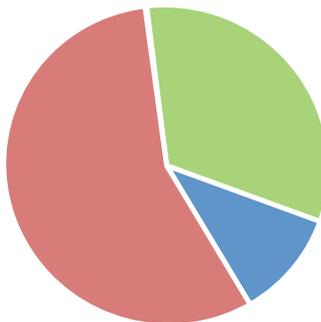
**Societal Benefit:** Do the individual and community welfare improvements exceed the program’s costs?



**Cashable Savings:** Will the government save money it can identify and use to pay for the program?

**Assessing the Relative Benefits of a PFS Contract for Employment Services**

**Societal Benefit:** Employment improves individual health, education outcomes and communities. It could reduce the need for other programs



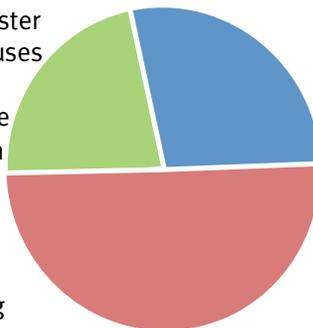
**Willingness to Pay:** Many welfare programs limit benefits and/or tie them to employment. Moving people from welfare to employment will likely be considered worth the investment.

**Cashable Savings:** Unemployment programs have almost no state funds, so there is little potential for cashable savings.

**Assessing the Relative Benefits of a PFS Contract for Family Preservation**

**Willingness to Pay:** Few people consider the personal impact of foster care until a child in the system causes trouble. Keeping children in their families may be a better alternative than extending benefits to children who age out of foster care.

**Societal Benefit:** Keeping families intact and teaching good parenting can produce stronger communities and better outcomes for children and parents alike.



**Cashable Savings:** Keeping children out of foster care, or limiting their time in the system can reduce costs of support and incentives.

**Part 6**

## Challenges with Pay for Success Contracting

Some center-right organizations in the U.S. have been wary of the potential for governments to incur obligations with “no money down” and less accountability than promised. In general their skepticism has led them to ignore the PFS financing mechanism, but the Libertas Institute provided a principled critique when the Utah legislature passed a bill to implement a PFS contract in 2014.<sup>19</sup> It did not help that the initiative started under a Labour government in the UK, that a progressive think tank wrote the first papers on it in the U.S., or that Mayor Bloomberg and former Massachusetts Gov. Deval Patrick were the first out of the gates with projects. For some policy experts, it seemed like a public-private partnership in reverse, adding obligations later instead of providing cash up front. They also did not trust the ability of evaluators and government officials to honestly admit if a program did not reach its goals.

Those on the center-left have wondered whether private investment alone can make government failures successful. Rick Cohen was very skeptical when he examined PFS contracts in a series of articles for *Nonprofit Quarterly* in 2014. PFS contracts, he concluded, are a “bipartisan dream built on a belief in the efficacy of the free market system that hasn’t borne much social progress fruit in recent years and [is] rooted in a disparaging view of public servants, who have accomplished more than most free market true believers might ever guess.”<sup>20</sup> If the programs being pursued had enough evidence to entice private investors and make a policy change to create PFS contracts, Cohen argued, then there was likely enough evidence to just make the program government policy and either enter a performance-based contract at the agency or make a performance-based appropriation in the legislature. Doug Sheketoff, executive director of the Oregon Center for Public Policy, followed a similar tack against a PFS experiment in that state, saying the state should instead “directly invest the money in programs for prevention of child abuse and neglect and their rigorous evaluation. Lawmakers should reject financiers and other unnecessary, costly intermediaries, and instead allow Oregon taxpayers to accrue all the financial savings from important, successful prevention efforts.”<sup>21</sup>

## A. The Challenges

We examine some of these challenges in more detail here.

### *1. Defining Goals and Performance Measures*

One of those universal problems in public sector management that becomes even more acute when constructing a PFS contract is defining the goal of a project. Is the primary goal to save money or expand access? What subpopulation will be targeted? In broad terms, what does success look like? This requires thought within the contracting agency about what is realistically possible, and strategic direction from the legislature and governor (or city council and mayor/manager) about the goals that are worth pursuing.

### *2. Setting and Keeping Benchmarks*

Politicians and government workers are even more reluctant than evaluators to admit when a program does not work. Again, the Utah pre-kindergarten expansion offers lessons. Contract staff are limited in what they set as benchmarks by what the politicians and program directors want. Once the program is up and running, the temptation may be great to give it more time and money to turn things around. The early disappointment of Rikers Island shows that this temptation can and should be avoided.

Under the best of circumstances, managers can struggle to define how to accomplish their strategic goals and the right metrics to know if a project is on track to succeed. Most PFS projects try to apply this discipline to new goals: recidivism reduction instead of population maintenance for prisons, third-grade success instead of advancement through the program for early childhood interventions, or long-term employment instead of income maintenance for unemployment programs. Managers may need better measures, which means better processes and data systems, to answer the new questions that define progress toward their new goals.

### *3. Preventing Undue Expansion of Government*

Once goals are set, there is still a concern that PFS contracting can be used as a way to expand government through a backdoor. Legislatures in New York, Colorado<sup>22</sup> and Texas<sup>23</sup> appropriated funds to an escrow account when they authorized their governments to enter Pay for Success contracts, which reduces the risk to private investors that they will not be paid and so reduces the

premium they can demand to cover that risk. Appropriating funds in advance to pay for potential success makes the otherwise theoretical policy discussion more salient for legislators, which can limit the risk of the PFS contract creating a future unaffordable expansion of government. Putting payment first also offsets the challenge of finding an agency to pay for a program when the benefits accrue to another agency—the “wrong pockets problem.” For example, early childhood programs are often funded through a state’s Department of Health and Human Services but the public school system saves money with less remediation. Employment programs are funded through the Commerce or Health and Human Services, but the biggest beneficiary may be the Corrections and Revenue departments.

Provisions in legislation or in the PFS contract itself can specify that any new dollars to pay for a program must be offset by reductions elsewhere. As just noted, this can be difficult when one agency pays for a program that reduces cost elsewhere in state government (or in another government altogether), but one way to redirect funds is from a program that is unproven or unsuccessful to one that has demonstrated success through a PFS contract. If a Nurse Family Partnership pilot does well, for example, the state could reapportion funds from pre-kindergarten programs that have little or no effect on school performance. This is, after all, the premise of PFS contracts—stop paying for failure and start paying for outcomes.

The open advocacy for PFS contracts as a way to pay for prevention of later problems, instead of as a substitute for existing programs also increases the concerns that these contracts are simply stalking horses to expand government while promising to share risks with the private sector, just as the earned-income tax credit (EITC) became a supplement to traditional welfare programs instead of the substitute that Milton Friedman originally intended.

Many philanthropists see government resources as nearly limitless. Philanthropists and foundations generally have seen their role as providing seed capital for new government programs rather than providing a way to redirect funds from current ineffective prevention programs. Anthony Iton, senior vice president for healthy communities at the California Endowment, told participants at the USC Center on Philanthropy & Public Policy’s 2016 National Leadership Forum, “Philanthropy has a bag of nickels when compared to government.”<sup>24</sup>

#### *4. Bolstering Government’s Contracting Expertise*

Government contract and legal staff can be at a marked disadvantage when trying to protect the taxpayers’ interest in their negotiations. They generally do not have to work on risk-sharing contracts that demand stringent measures of success, and they have little at stake themselves if the

contract goes wrong. Further, government staff face different financial incentives, and may have different skill sets and lack relevant PFS contracting expertise relative to the private investors' negotiation teams. If they are not able to offset the gaps in expertise, governments sometimes bring in contracting and negotiation expertise from outside sources.

### *5. Evaluating the Evaluator*

The independent evaluator is the lynchpin of any PFS contract, determining whether the program has met its payment benchmarks. With such great responsibility, however, also comes risks. It is imperative to find the right evaluator and structure incentives to ensure objectivity.

Evaluators, like others in a PFS contract, have some commitment to the program's success. Part of that commitment is simply from the desire to see something work in the critical human need the program addresses. Other factors include the desire to see PFS contracts succeed and to get more work. Because evidence and data are open to interpretation, success can depend on what question the evaluator sought to answer.

For example, *The New York Times* questioned the declared success of a preschool expansion PFS contract in Utah. That program identified 110 preschool students as at risk of school failure, then declared success when just one child needed special services in kindergarten. Critics contended that most children do not need services until later in their school careers, so kindergarten was too soon to declare success.<sup>25</sup> More broadly, early childhood programs have had mixed results since the first Perry Preschool Project had success in the 1960s with poor children at risk of failing school.<sup>26</sup> Conventional wisdom, however, insists that universal pre-k, not just targeted interventions, is cost-effective despite abundant evidence to the contrary.<sup>27</sup>

### *6. Adapting the Model*

While many government leaders value the evidence-based practices PFS contracts bring, they hesitate to use such a new and unproven method. More experience with PFS contracts will not only make government leaders more likely to use them, but will explore the different ways they can be adapted to various types of programs. In addition, programs will likely need to increase in appropriate metrics of success. Rather than the traditional measures of community need and number of people served by a program, an appropriate measure may be the percentage of people who have successfully completed a program and who no longer need other services. Project managers may need to determine whether they are paying for the program or for the results, and whether changes made

to a program's design and operations after the initial launch are simply improvements to the model or are instead designed to manipulate the results.

### *7. Paying for the Old and New Programs*

Under a traditional contract to pilot new services, the government pays for the existing program and the pilot program at the same time from the start until such time as it replaces the old program or cancels the pilot. PFS advocates promise governments that they can avoid this problem of paying for two programs simultaneously. The government saves enough money over the life of the project to pay investors and continue the new program. Government only pays for services once—either the old program while measuring the success of the new program, or the successful new program based on savings from the old program (and any new appropriations).

As noted earlier, however, the PFS model may not produce enough cashable savings to offset the cost of the new program, so there may be net new spending, which means paying twice. If the new program proves successful, the government must repay the investors from the savings and any additional investment it chooses to make, which still leaves open the continued operation of the program. Policymakers can acknowledge the potential need to pay simultaneously for an existing program and a new program by appropriating funds into an escrow-type reserve fund when they authorize PFS contracts, as described above.

### *8. Changing Culture*

An overarching goal for PFS contracts is for governments to learn what is proven to work and only pay for those programs. Transforming how government pays for human services to focus on outcomes instead of services provided will not be easy.

Contracts to date address a small fraction of total spending on human services. The median PFS contract as of July 2015 treated 415 people with an investment of \$1.65 million.<sup>28</sup> Goldman Sachs' investment for the Rikers Island project was \$7.2 million over three years, at a facility with an \$860 million annual budget. It will take concerted effort over a protracted period of time to embed the premises and practices of PFS contracts broadly into government procurement and service provision, which is the final measure of their success.

To illustrate how daunting the challenge is, consider that General Motors tried massive investments in the 1980s to right its own course, but took decades to apply lessons from those initiatives in a significant way in other manufacturing and sales processes. GM entered a joint venture with Toyota

in Fremont, California, in part to learn how the Japanese company profitably produced small cars with exceptionally few defects. GM also created an entirely new company in Saturn, building new vehicles with new engines at a new factory and selling them through a new network of dealers. Despite the massive investments, neither corporate management nor the unionized workforce fully embraced the experiments in California or Tennessee, and GM officially ended them in 2009.

Can governments adopt a fundamental shift in how they do business from a small number of experiments when an equally large private company, whose very existence depended on adaptation, could not accomplish a similar transformation with larger bets? The limited scope and scale of initial PFS contracts may be an asset in this process because they provide more opportunities to learn with lower risk and do not divert resources from other programs as visibly as the GM ventures did. Before examining some of the results from existing PFS contracts in the next section, we offer some questions to ask before undertaking a new project.

## B. Addressing the Challenges

Here are 10 questions governments should ask in a Pay for Success project to address the challenges discussed in this section. Most of them are applicable to any government contract or program. A sign that the culture has changed would be that every program goes through a similar series of questions, whether formally or informally.

1. What do we want to accomplish?
2. What is success?
3. How do we measure success and progress?
4. How can we ensure this is not just new spending?
5. How do we match benefits and costs?
6. How can we write and enforce a contract with investment banks?
7. How do we ensure the evaluator is not biased?
8. How do we balance fidelity to the model and adaptability to local circumstances?
9. How do we continue the program, if it is successful?
10. How can we change the procurement culture and apply lessons to other government contracts?

## Part 7

# Results from Early Implementation Projects

As Pay for Success contracts begin to mature and reach payout milestones, the results so far have been mixed. Projects with softer measures have reported more successes, and at least one has faced criticism for being too lenient in its evaluation. This section focuses on projects that have hit payout milestones, plus one in which the contract itself marks a milestone. We discuss the HM Prison Peterborough and Rikers Island recidivism projects, Utah’s pre-k expansion, 10 projects focused on youth education and employment in the UK, two family-focused projects in Australia, and the financing difficulty of South Carolina’s Nurse Family Partnership project. Some comparisons are included in Table 2.

## A. HM Prison Peterborough

The very first PFS contract aimed to reduce recidivism among inmates with short sentences at HM Prison Peterborough in the UK. Three cohorts of 1,000 men sentenced to less than 12 months in prison received interventions to rehabilitate them. The first cohort had 142 reconvictions per 100 prisoners compared to 155 reconvictions per 100 prisoners in a control group—an 8.4% reduction. This fell short of the 10% reduction needed to trigger payments. Investors can still receive a payment in 2016 if reconvictions are 7.5% lower for the first two cohorts combined.<sup>29</sup>

A nationwide Transforming Rehabilitation initiative supplanted the narrowly targeted HM Prison Peterborough project in 2015. The new initiative will serve 45,000 inmates and tie payment to results, but it will be an entirely government-funded program with no private investors.<sup>30</sup>

RAND Europe, in its final evaluation report for the Ministry of Justice found that the HM Prison Peterborough offenders thought they received better support through this program than they had in the past when released from prison. Those involved in the project from all sides saw that the service provider could be more flexible and made a number of innovations, but “**these innovations were not necessarily a result of SIB funding**, as other (non-SIB funded) initiatives have exhibited similar characteristics.” [emphasis in original]<sup>31</sup> If innovation and flexibility do not depend on the

financing mechanism, governments should be able to apply lessons from PFS projects to other contracts and programs. On the other hand, it also points to a need for realistic expectations about the ability to recruit participants in any program or to do long-term tracking of those who have completed a program.<sup>32</sup>

## B. Rikers Island

In 2012, New York City launched the first PFS contract in America with a project also aimed at recidivism reduction, this time among youth offenders between the ages of 16 and 18 at the Rikers Island jail. Goldman Sachs provided a \$9.6 million loan, guaranteed by a \$7.2 million grant from Bloomberg Charities, to implement evidence-based treatment aimed at “improving social skills, personal responsibility, and decision making.”<sup>33</sup> If the program reduced the number of days participants in the program spent in jail after their initial release by 10% compared to a control group, the government would pay. If not, the Bloomberg Charities grant would cover Goldman’s investment.

Vera Institute determined that the program had no impact on recidivism.<sup>34</sup> City government ended the contract after just three years, and Bloomberg Philanthropies covered \$6 million of Goldman Sachs’ \$7.2 million investment (each recovered the remainder of its unspent funds). Proponents said the PFS contract was a success as it set a precedent to end an ineffective program and provided evidence at no cost to the government.<sup>35</sup> Critics contended that the result was an expensive failure for the city given the resources that went into developing the program and contract, even if the city did not pay for the program itself.<sup>36</sup>

Clearly the proponents oversell PFS contracts when they claim there are no costs, no risks and only benefits. Critics are right that the city bore at least opportunity costs in developing the contract and monitoring the program. The relevant questions, however, concern how PFS contracts compare to traditional methods of program development and evaluation. Simply going through the process provides lessons for other contracts, including how to end a program that fails to meet its stated objective.

## C. Utah Pre-K

Pre-kindergarten is the focus of an ongoing PFS contract in Utah that had early support from the J.B. and M.K. Pritzker Family Foundation and Goldman Sachs.<sup>37</sup> Pritzker provided payment guarantees

in Salt Lake City to the partners, much as Bloomberg did in New York City. The private partners reached agreement in June 2013, a month before Salt Lake County agreed to provide \$350,000 in payments. The Utah Legislature followed a year later with \$3 million in annual appropriations to an escrow account for success payments.<sup>38</sup>

In its first year, the program enrolled 595 low-income three- and four-year-old children in a high quality preschool. A program fact sheet explains:

*Based on a test administered when entering preschool and other evidence based risk factors, 110 of the four-year-olds were identified at highest risk for school failure. Without high-quality preschool, these students would likely enter school at a delayed level, increasing the probability of them being delayed academically and potentially assigned to special education during their academic years. These children in the highest risk group are not predicted to be assigned to special education in kindergarten or at any other grade, but are deemed to be at a high risk of special education assignment[.]*<sup>39</sup>

One of those 110 identified children used special education services in kindergarten, which translated into an estimated \$281,550 in savings for the state based on state payments to school districts of \$2,607 per child for special education. Investors were slated to receive 95% of the savings, or \$267,000.

A number of outside observers questioned the results and calculated savings. Among the issues raised were: less than 12% of all Utah public school students receive special education services, only one-third of students who will use special education services in their school career are identified in kindergarten, and the more intensive and costly services cannot be identified until later.<sup>40</sup> In addition, most preschool programs have reduced special education needs by at most 20%, and even the best programs have yielded 50% reductions, not the 99% attributed to the Utah program. The quality of preschool in this pilot also drew concern.<sup>41</sup> The critiques highlight the challenges of setting appropriate expectations for savings and maintaining quality standards.

## D. UK Innovation Fund

The UK Department for Work and Pensions entered 10 PFS contracts in 2012 (six pilot projects in April and four others in November) to improve the prospects of 17,000 youth aged 14 to 24 who were not in education, employment or training (NEETs). Each contract had specific payments for individual results, for example a program could receive up to £3,500 (\$5,000) when a participant

took employment and another £2,000 (\$2,900) for “sustained employment,” with a maximum of £11,700 (\$16,900) per individual.<sup>42</sup>

Three of 10 employment and education programs in the UK were declared successes and given new contracts by the Department of Works and Pensions, though they have not reported full results.<sup>43</sup> The other seven have not reported results as of April 2016. A 2014 progress report from DWP found that projects aimed at short-term quantifiable outcomes worked better with PFS contracts than those pursuing long-term outcomes. It also found that programs to keep students in school and on the path to employment were easier to monetize than those that sought to get youth back into education, employment or training.<sup>44</sup>

## E. Australia’s Social Benevolent Bonds

Australia’s two social benefit bond programs, in New South Wales, have paid interest to investors in their first years based on the programs’ ability to strengthen families and keep children out of foster care, or to restore children from foster care to their families. Critics have charged that the restorations have not always lasted, so the payments may have overvalued outcomes. The Newpin Bond is worth A\$7 million (US\$5.5 million) over seven years to return children from foster care to 700 families. The Benevolent Society Bond of A\$10 million (US\$7.8 million) seeks to assist 400 families and children through crisis to preserve the family.<sup>45</sup>

## F. South Carolina Nurse Family Partnership

Although it is just getting underway, a project in South Carolina provides a vivid example of the “wrong pockets” problem and the importance of philanthropic investment. Gov. Nikki Haley’s administration worked nearly four years with the Duke Endowment, Harvard’s SIB Lab, Social Finance, and others to expand a nurse home visit program across the state. Most of the 2,000 additional families who would receive the services are on Medicaid, which means 71.3% of the savings would accrue to the federal government. In the end, philanthropic funders committed \$17 million and the federal government agreed to finance \$13 million through a Medicaid waiver. South Carolina will pay investors up to \$7.5 million to sustain the program’s services if it achieves positive results.<sup>46</sup>

| Project  | Place         | Start Date     | Focus                          | Target population  | RESULT  | Status  |
|--|---------------|----------------|--------------------------------|--|---|---|
| <i>HMP Peterborough</i>  | UK            | March 2010     | Prison recidivism              | Three cohorts of 1,000   | 8.4% reduction in recidivism missed 10% target, may still beat 7.5% target for multiple cohorts, and earn payment       | Replaced by national post-release program   |
| <i>Rikers Island</i>   | New York City | September 2012 | Prison recidivism              | 10,000 adolescent inmates  | No reduction in recidivism. Bloomberg Philanthropies covered \$6.0 million of \$7.2 million investment of Goldman Sachs | Ended August 2015, one year early.  |
| <i>High Quality Preschool</i>  | Utah          | August 2013    | Preschool access               | 600 / year Up to 3,500   | 1 of 110 identified at-risk students needed remedial or special education   | Made \$260,000 payment October 2015   |
| <i>Newpin</i>  | Australia     | June 2013      | Family restoration             | 700 families   | Increased family restoration vs counterfactual  | Made first annual interest payment  |
| <i>Benevolent Society</i>  | Australia     | October 2013   | Family environment             | 400 families   | Improved performance on metrics (out-of-home care, helpline reports, and safety and risk assessments) by more than 5%   | Made first annual interest payment  |
| <i>UK DWP Innovation Fund Round 1: APM UK Ltd</i>                        | UK            | April 2012     | Youth education and employment | 2,897 14 to 24 year-olds   | Advance Program: no results reported as of April 1, 2016  | Not reported as of April 1, 2016  |
| <i>UK DWP Innovation Fund Round 1: Stratford Development Partnership</i> | UK            | April 2012     | Youth education and employment | 740 disadvantaged 14 to 19 year-olds   | Links4Life: no results reported as of April 1, 2016   | Not reported as of April 1, 2016  |
| <i>UK DWP Innovation Fund Round 1: Indigo Project Solutions</i>          | UK            | April 2012     | Youth education and employment | 90 14 to 17 year old students, 60 16 to 17 year old NEETs, 150 18 to 24 year old NEETs | Living Balance: no results reported as of April 1, 2016   | Not reported as of April 1, 2016  |
| <i>UK DWP Innovation Fund Round 1: Nottingham City Council</i>           | UK            | April 2012     | Youth education and employment | Over 3,000 16 to 24 year-olds  | Employer Hub and Nottingham Futures: no results reported as of April 1, 2016  | Not reported as of April 1, 2016  |
| <i>UK DWP Innovation Fund Round 1: Private Equity Foundation</i>         | UK            | April 2012     | Youth education and employment | 1,050 at-risk 14 to 18 year-olds   | ThinkForward: no results reported as of April 1, 2016   | Not reported as of April 1, 2016  |
| <i>UK DWP Innovation Fund Round 1: Triodos Bank</i>                      | UK            | April 2012     | Youth education and employment | 3,900 disadvantaged 14 to 19 year-olds   | Career Connect, Triodos New Horizon: achieved goals for attitudes, behavior, national qualifications, and employment    | Repaid investors: Awarded second PFS contract in April 2015 through DWP Youth Engagement Fund |
| <i>UK DWP Innovation Fund Round 2: Prevista</i>                          | UK            | November 2012  | Youth education and employment | Unspecified number of 14 to 16 year-olds   | Multiple Projects: no results reported as of April 1, 2016  | Awarded second PFS contract in April 2015 through DWP Youth Engagement Fund                   |
| <i>UK DWP Innovation Fund Round 2: Social Finance (Adviza)</i>           | UK            | November 2012  | Youth education and employment | 1,500 to 2,000 14 to 15 year-olds  | Energise program: exceeded benchmarks on attitudes, behavior, education and employment outcomes                         | Repaid investors  |
| <i>UK DWP Innovation Fund Round 2: Social Finance (COUI)</i>             | UK            | November 2012  | Youth education and employment | At least 1,152 14 to 15 year-olds  | Teens & Toddlers program: achieved goals for attitudes, behavior, and national qualifications                           | Repaid investors, Awarded second PFS contract in April 2015 through DWP Youth Engagement Fund |
| <i>UK DWP Innovation Fund Round 2: 3SC</i>                               | UK            | November 2012  | Youth education and employment | 720 14 to 16 year-olds   | 3SC Capitalise: no results reported as of April 1, 2016   | Not reported as of April 1, 2016  |

Sources: Brookings Institution, government publications, Goldman Sachs, Social Finance UK, Good Finance

## Part 8

# Lessons Learned in Pay for Success Contracting

Several lessons in PFS contracting have emerged in the past five years:

### A. Set Money Aside Up Front

Part of the pitch for PFS contracts has been the delayed payment from government. That does not mean governments should just wait until the program succeeds to appropriate funds needed to repay investors. A reasonable approach taken by some states has been to appropriate funds to a special reserve fund that serves as an escrow account under the state controller, treasurer or budget director instead of a particular agency. This can assure private sector investors know they will get paid if they are successful, which should reduce the risk premium they demand, and thereby reduce the cost to government. The appropriation will satisfy progressives who see PFS as a way to fund new programs, providers who would otherwise worry that government has no stake in the program's success, and limited government advocates who want the cost of any government expansion acknowledged.

Establishing a reserve fund reduces the “wrong pockets problem”<sup>47</sup> of trying to pay for today's program costs in one agency with tomorrow's benefits to another agency, such as paying for prison work training programs with funds from housing, health and other human service programs. The challenge still remains when Medicaid or local government has lower costs from a successful state program, if citizens benefit with no savings for government, or if benefits are too far in the future to be captured. If the money is there, the government can make its success payments without cutting the funds available to an agency based on some approximation of benefits.

## B. Realize That Success Is More Than Savings

Pay for Success may have originally been appealing because of the overly ambitious promise that the programs would pay for themselves with savings in existing programs, but outcomes should be the true measure of success. Even if the savings that accrue over the contract period can be identified and actually do cover program costs, it is difficult to capture those savings. Social well-being improvements and public willingness to pay should be used to complement cashable savings in setting the price the government will pay.

## C. Adapt the Model After Initial Success

Success in one setting may not continue with a different set of rules. In 2015, North Carolina sought projects that had adequate private support to expand operations but whose capital costs the government could cover with a PFS contract. The state also sought opportunities to pay for private evaluations of existing cost-ineffective state programs with savings from the programs upon repeal. Either method would leave government with only a single payment instead of a new operating expense and a potential double payment when transitioning from PFS to a regular operating program.

With a program that needs continuing government support, it would be sensible to renew the PFS contract instead of trying to bring the program into government or make it a traditional grant-funded project. It is difficult to disaggregate how much of the program's success was due to the contract structure, management, staff, or other factors and how changing any or all of those factors would affect performance. If it is successful having started in a PFS setting, governments would be wise to keep it in a performance-based contract setting moving forward. This is what the few PFS programs that have proven successful have chosen to do.<sup>48</sup>

## D. Seek Expertise

A small but growing community of foundations, scholars, lawyers, consultants and project leaders have studied or participated in some aspect of PFS. Putting together a contract this complex will require a full effort from all areas of the government. The more it can leverage outside resources, the better prepared its own staff can be. With counterparties in investment banking and other private investors seeking a return on their capital, governments need as much help as they can get.

## E. Transform the Culture

State governments are multi-billion dollar enterprises. The largest PFS contract to date is Massachusetts' six-year, \$24.5 million chronic homeless project, and the average project had upfront commitments equal to about a million dollars per year. If Pay for Success is to make a significant impact, the new approach to evaluation and contracting will need to expand beyond its niche and become standard practice in government procurement of goods and services. General Motors could not accomplish such a transformation from its 20-year experiments with Saturn and NUMMI to the rest of the company despite facing existential threats from competition, and it eventually was rescued by the federal government. Can governments prove to be wiser with less visible threats?

**Part 9**

# Conclusion

Pay for Success (PFS) contracting is the latest iteration of public-private partnerships with greater risk—particularly financial risk—more clearly being borne by the private partners in social services than previously attempted. Private investors in toll roads, parking garages and other public sector infrastructure projects are now accustomed to paying up front in anticipation of earning a return on investment over time. They have had the advantage of seeking payment directly from drivers, tenants or some other customers who must find value for their money. By contrast, social services are indirectly paid by government on behalf of a client, which means value must be determined collectively instead of individually in a PFS contract.

Trusted evaluators applying reasonable evaluation strategies and techniques are central to the sustainable success of PFS contracting. Two projects that attempted to keep former inmates from returning to prison fell short of their marks. Programs to improve education, family ties and housing have cleared their hurdles, but observers have raised questions about the contracts and results in some of these.

States and localities negotiate PFS contracts with savvy counterparties who have experience limiting their exposure to risk, not simply with nonprofit service providers. Further, early investors in PFS contracts are gaining experience that each government will have to develop itself or acquire from other governments (with a loss of information in the process) or consultants (which will add another cost). Skeptics contend that the upfront costs of project identification and contract development are not counted when advocates say government only pays if a PFS project is successful.

Government's challenge is to find a way to write and enforce good contracts, budget for success, define their desired outcomes, reliably evaluate programs, abandon failed ventures, and faithfully expand or replicate promising programs. It goes beyond getting the right people in procurement and program positions, but extends to the willingness of agency directors, budget staff, legislative staff, legislators and the governor himself to experiment and possibly fail. It requires using the right processes, data and technology. This is a high bar to set, and missing it does not mean PFS contracts will have been a waste, but not setting it means resigning oneself to more wasted resources and wasted lives.

## About the Author

**Joe Coletti** is co-founder and CEO of the Better Yes Network, which connects nonprofit organizations and donors to restore individuals and communities through personal relationship and responsibility. He led the North Carolina Government Efficiency and Reform (NC GEAR) initiative, which included an exploration of PFS contracts in human services, education and public safety. He joined PFS pioneer Jitinder Kohli and others in a paper on PFS for the Center for American Progress.

Coletti was the director of health and fiscal policy studies for the John Locke Foundation in North Carolina and policy specialist for the State Policy Network, which supported state-focused, liberty-minded policy institutes. He has degrees from the University of Michigan in Ann Arbor and the Johns Hopkins School of Advanced International Studies (SAIS).

# Additional Resources

## **ASSISTANCE AND CASE STUDIES**

Harvard Government Performance Lab

<http://govlab.hks.harvard.edu/social-impact-bond-lab>

Government Document Library (RFIs, RFPs, Contracts, Legislation, etc)

<http://govlab.hks.harvard.edu/government-documents>

Social Finance US

<http://socialfinance.org>

Urban Institute

<http://pfs.urban.org>

Third Sector Capital

<http://www.thirdsectorcap.org>

UK Centre for Social Impact Bonds

[https://data.gov.uk/sib\\_knowledge\\_box/](https://data.gov.uk/sib_knowledge_box/)

## **NEWS AND INFORMATION SITES**

Social Impact Bond Review—includes links to other sites, papers, and trackers

<http://www.sibreview.com>

PayForSuccess.org activity map

<http://www.payforsuccess.org/pay-success-deals-united-states>

Instiglio

<http://financeforgood.ca>

Finance for Good

<http://financeforgood.ca>

## **RFI RESPONSES**

North Carolina RFI responses

[http://ncgear.nc.gov/documents/Pay%20for%20Success%20RFI%20Responses\\_revised%20820.pdf](http://ncgear.nc.gov/documents/Pay%20for%20Success%20RFI%20Responses_revised%20820.pdf)

Pennsylvania RFI responses

[http://www.budget.pa.gov/Programs/Pay\\_for\\_Success/Documents/Pay%20For%20Success%20RFI\\_1.pdf](http://www.budget.pa.gov/Programs/Pay_for_Success/Documents/Pay%20For%20Success%20RFI_1.pdf)

[http://www.budget.pa.gov/Programs/Pay\\_for\\_Success/Documents/Pay%20For%20Success%20RFI\\_2.pdf](http://www.budget.pa.gov/Programs/Pay_for_Success/Documents/Pay%20For%20Success%20RFI_2.pdf)

## **SAMPLE LEGISLATION**

Utah HB 96

<http://le.utah.gov/~2014/bills/static/HB0096.html>

Colorado HB 15-1317

[http://tornado.state.co.us/gov\\_dir/leg\\_dir/olls/sl2015a/sl\\_205.htm](http://tornado.state.co.us/gov_dir/leg_dir/olls/sl2015a/sl_205.htm)

Texas HB 3014

<http://www.legis.state.tx.us/tlodocs/84R/billtext/html/HB03014S.htm>

# Endnotes

- <sup>1</sup> For this paper, “Pay for Success contract” or “PFS contract” is synonymous with “Social Impact Bond” or “SIB”
- <sup>2</sup> Jeffrey B. Liebman, “Social Impact Bonds: A Promising New Financing Model to Accelerate Social Innovation and Improve Government Performance,” Center for American Progress, February 2011.
- <sup>3</sup> Nathaniel Popper, “Success Metrics Questioned in School Program Funded by Goldman,” *The New York Times*, November 3, 2015. <http://www.nytimes.com/2015/11/04/business/dealbook/did-goldman-make-the-grade.html>.
- <sup>4</sup> “Evaluation of the Joint Development Phase of the NSW Social Benefit Bonds Trial,” KPMG, January 2014.
- <sup>5</sup> “Pay for Success U.S. Activity,” Pay for Success Learning Hub. <http://www.payforsuccess.org/pay-success-deals-united-states>.
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5737 Mesmer Ave.  
Los Angeles, CA 90230  
310-391-2245  
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