Impact Investments and Social Impact Bonds in the United States: Lessons for Japan

PREFACE

The Institute of Nonprofit and Public Management Studies (INPMS) at Meiji University has been conducting research on the effects of impact investments on public service provision by nonprofit organizations and social enterprises in the UK, the US and Japan. In particular, INPMS has been exploring the ways in which impact investments, especially social impact bonds (SIBs), affect governments, social service providers, service users, and the quality of social services in the UK and the US. The aim of this research is to gain an understanding of the UK and US experiences and to apply the lessons learned to develop Japanese SIB models.

As part of this research, from January 12 to January 16, 2015, in New York City and Boston in the US, the INPMS project members interviewed eight organizations and two experts of impact investments, SIBs, and social enterprises. This report focuses on three interviews which are the most relevant to SIBs and Pay for Success. (The interview with Goldman Sachs is required to be confidential.) This report is written by Tania Dowhaniuk and edited by Dr. Takayuki Yoshioka.

Table of Contents

INTRODUCTION TO SOCIAL IMPACT BONDS

In recent years, the impact investment market has grown and awareness about such social values-driven investments has increased among social investors, nonprofit organizations, social enterprises, businesses and governments. Impact investments have been considered a catalyst for innovation in public private partnerships, and provide access for nonprofits and social enterprises to alternative financial resources from that of conventional government funding.

In particular, within the impact investment market, social impact bonds (SIBs) have been generating worldwide interest since the world's first SIB was launched in 2010 at Peterborough Prison in England. According to Nicholls and Tomkinson (2013)[1], "It aims to improve a social outcome through the collaboration of government, service providers and external investors. Put simply, a SIB involves a set of contracts, the basis of which is an agreement by government to pay investors for an improvement in a specific social outcome once it has been achieved" (p.3). More than 40 SIBs have already been operating around the world, aiming to improve outcomes in diverse social service areas. In most cases, these outcomes are related to preventative interventions addressing recidivism, homelessness, youth unemployment, and juvenile delinquency; improvements are connected to cost savings on public services.

In the US, there are seven active SIBs or Pay for Success (PFS) projects in issue areas including homelessness, early childhood education, and recidivism. Many more SIBs are in the planning stage and interest is growing, as more state and county governents put out requests for proposals for PFS contracts in increasingly diverse issue areas; such as family strengthening, child welfare, child and maternal health, mental health, workforce development and education.

---

[1] Nicholls, A. & Tomkinson, E. (2013). The Peterborough Pilot Social Impact Bond. Oxford: Saïd Business School, Oxford University.

INPMS Project Team

Principal Investigator	
Ichiro Tsukamoto	Professor of Public Management, School of Business Administration, Meiji University
Co-Investigators	
Takanori Chiba	Professor of Environmental Accounting, School of Business Administration, Meiji University
Nobusato Kitaoji	Professor of Public Management, Graduate School of Governance Studies, Meiji University
Masao Seki	Associate Professor of Corporate Social Responsibility, School of Business Administration, Meiji University
Ikuyo Kaneko	Assistant Professor, Public Management, School of Business Administration, Meiji University
Toshihiro Mori	Professor of Finance, Graduate School of Management, Ritsumeikan University
Hajime Imamura	Professor of Social Economy, Faculty of Economics, Toyo University
Mariko Nishimura	Professor of Public Policy, Faculty of Law, Meiji-Gakuin University
Hideaki Baba	Associate Professor of Governmental & Nonprofit Accounting, Faculty of Business and Commerce, Kansai University
Staff	
Takayuki Yoshioka	Research Fellow, INPMS, Meiji University
Hiroshi Tanji	Research Assistant, INPMS, Meiji University, and PhD Candidate, Graduate School of Humanities, Meiji University
Tania Dowhaniuk	Research Assistant, INPMS, Meiji University, and MPP Candidate, Graduate School of Governance Studies, Meiji University

US Study Tour Participants

Principal Investigator	
Ichiro Tsukamoto	Professor of Public Management, School of Business Administration, Meiji University
Co-Investigators	
Takanori Chiba	Professor of Environmental Accounting, School of Business Administration, Meiji University
Masao Seki	Associate Professor of Corporate Social Responsibility, School of Business Administration, Meiji University
Ikuyo Kaneko	Assistant Professor, Public Management, School of Business Administration, Meiji University
Toshihiro Mori	Professor of Finance, Graduate School of Management, Ritsumeikan University
Hajime Imamura	Professor of Social Economy, Faculty of Economics, Toyo University
Hideaki Baba	Associate Professor of Governmental & Nonprofit Accounting, Faculty of Business and Commerce, Kansai University
Staff	
Takayuki Yoshioka	Research Fellow, INPMS, Meiji University
Tania Dowhaniuk	Research Assistant, INPMS, Meiji University, and MPP Candidate, Graduate School of Governance Studies, Meiji University
Observers	
Taro Suzuki	Yokohama City Council Member (Liberal Democratic Party)
Yasuyuki Kawashima	Inagi City Council Member (Independent)
Kanako Shinden	Social Innovation Team Member, Social Innovation Program Division, Nippon Foundation
Yoshiki Yamada	CEO, Greensync Inc.

Interview Schedule

	Schedule	Interviewees
1/12 Mon.	**Goldman Sachs** 13:30-14:15 at 200 West Street New York, NY10282	**Ms. Andrea Phillips** (Vice President in the Urban Investment Group)
	Professor James Michael Mandiberg 16:00-17:30 at 2180 Third Avenue at East 119th Street, New York, NY 10035	**Associate Professor James Michael Mandiberg, Ph.D.** (Silberman School of Social Work at Hunter College, the City University of New York)
1/13 Tue.	**Social Finance** 14:00-15:30 at 77 Summer Street, 2nd Floor, Boston, MA 02110	**Mr. Connor Morrison** (Associate) **Mr. Vignesh Nathan** (Associate) **Mr. Anant Udpa** (Associate)
1/14 Wed.	**Harvard Kennedy School Social Impact Bond Technical Assistance Lab** 12:00-13:30 at New York Marriott East Side Hotel	**Mr. Ryan Gillette** (Assistant Director for the Harvard Kennedy School SIB Technical Assistance Lab) **Ms. Hanna Azemati** (Director of Social Innovation Financing at New York State)
	The Empowerment Center 16:00-17:30 at 20 East First Street Mount Vernon, New York 10550	**Mr. James J. Rye** (Executive Director) **Mr. Dwayne Mayes** (Director of Technical Assistance) **Mr. Mark Iskowitz** (Chief Financial Officer)
1/15 Thu.	**MDRC** 10:00-12:00 at 19th Floor, 16 East 34 Street New York, NY 10016-4326	**Mr. David Butler** (Senior Adviser) **Mr. Tim Rudd** (Research Associate) **Ms. Elisa Nicoletti** (Research Associate) **Ms. Mariana Veras** (Research Assistant)
	Business for Social Responsibility (BSR) 13:30-15:00 at 5 Union Square West, 6th Floor New York, NY 10003	**Mr. John Hodges** (Director of Financial Services) **Ms. Smruti Govan** (Associate, Partnership Development and Research)

1/16 Fri.	**Professor Norman I. Silber** 9:30-10:30 at New York Marriott East Side Hotel	**Norman Issac Silber, Ph.D., J.D.** (Professor of Law, Maurice A. Deane School of Law at Hofstra University)
	SeaChange Capital Partners 13:00-14:30 at 1385 Broadway, 23rd Floor New York, NY 10018	**Mr. John MacIntosh** (Partner) **Ms. Georgia Levenson Keohane** (Board member)
	Housing Works 17:00-18:00 at 57 Willoughby St., 2nd Floor, Brooklyn, NY 11201	**Mr. David Raper** (Senior Vice President, Business Enterprise & Human Resources)

INTERVIEW SUMMARIES

Social Finance

Introduction to Social Finance

Social Finance US was founded in January 2011, inspired by their sister organization in the UK, Social Finance, Ltd.; which was founded in 2007 and launched the world's first SIB in 2010. Social Finance Israel was founded in 2012 [2]. As sister companies, Social Finance US, UK and Israel share some members of the board of directors, the work they do is

Vignesh Nathan (left) & Connor Morrison (right)

similar and they share expertise, but they work independently. Two major differences between Social Finance UK and US are how long they have been operating and their access to funding. Social Finance UK's first project ran and was evaluated after two years in operation, whereas Social Finance US will not have the progress report for their New York State recidivism project[3] until the middle of 2017. With regards to funding, Social Finance US does not have access to a big government pool of money, like Big Society Capital in the UK.

In a Pay for Success (PFS) scheme, the preferred term for Social Impact Bonds (SIBs) in the US, Social Finance US (SF) is positioned as an intermediary and brings financial expertise to the project team. While SF does not invest its own money and brings in a separate firm to conduct the program evaluation; they handle the consulting work, set up the transaction and find investors who would be interested in putting money toward the project. Besides the New York State recidivism SIB[4], currently their

---

[2] Social Finance US: Our History (Retrieved 2015-07-16 from:
http://www.socialfinanceus.org/who-we-are/our-mission)
[3] Social Finance Drives Landmark New York State Deal (Retrieved 2015-07-16 from:
http://www.socialfinanceus.org/what-we-do/select-current-engagements/social-finance-drives-landmark-new-york-state-deal)

only finished transaction, SF is working on SIBs on a broad range of issue areas; including early childhood education, pre-natal health, teen pregnancy, homelessness and foster care.

Social Finance's PFS experience
Initial planning and project design

One lesson learned through their experiences to date is the importance of careful planning and project design, since the initial time invested for project design will pay off through an easier to manage project and avoid costly corrections to oversights after it is too late. SF also highlighted the importance of building partnerships and strong relationships with all stakeholders in the project team, including the service provider and key people in the government, so that unexpected changes can be more effectively and efficiently taken care of.

SF's first SIB took about a year from the start of the planning process until the actual project launch. The SIBs SF is currently working on are a bit faster to set up, but they still take a lot of work to consult with all the project team members to make sure everyone's interests and opinions are aligned. Making all parties involved aware of the time required for project design is essential; a lot of organizations expressed to SF that although they still would have participated, they wished they had known how much time and work was involved in the project design phase beforehand.

Because of the tremendous amount of project design work that goes into setting up a transaction, an SIB is only practicle to implement if it is above a minimum transaction amount. Regardless of the size of the project, whether for 25, 10, or two million dollars, the amount of time required from all participating members; including the government, the social service provider and intermediary; would be the same.

And all the work that goes into setting up a transaction; for example research and surveying; is sometimes funded by the government, but not always. SF and other project managers and intermediaries are usually paid across the life of the project, but not always for the pre-implementation project design work. While all intermediaries would like to get paid from project design to implementation in addition to the usual project management fee, for the first SIBs in the US some intermediaries were comfortable being paid for the project management fee only after the launch.

Setting up a PFS contract

Because of the minimum project size, SF usually works on projects funded by states or larger cities. Sometimes SF makes a suggestion or communicates an idea about

a project, but usually the state knows it wants to implement a PFS project and puts out a Request for Proposal (RFP) to select an intermediary, usually by a single round of bids through a competitive bidding process. There are usually three or four organizations that apply; some larger organizations like Third Sector Capital or SF that operate across the country, and some local entities that are focused on serving a particular geographic area, that are just entering the impact investment field.

When selecting an intermediary for an SIB scheme, governments have been open to different kinds of organizations playing that role. For example SF's core skill is being an intermediary with expertise in finance, while MDRC, the intermediary on the New York City Rikers Island SIB, specializes in evaluations; but both played similar roles in the SIB scheme.

Each state or city has its own policies, but in most cases, the service provider needs to be selected by a competitive bidding process, in which case SF is required to put out an RFP. The project evaluator is sometimes required to be selected using a competitive bidding process, but some cities and states allow an intermediary to select or subcontract the role.

While some remain skeptical about SIBs, a lot of foundations are enthusiastic about SIBs and are interested in getting involved. In the US, foundations have provided payment insurance or a guarantee for the other investors in SIB deals. In future projects, it would be preferable if such guarantees from foundations were not required. Some of the projects SF is currently working on have reduced amounts of insurance, and hopefully after a few years, philanthropic guarantees or insurance will not be a standard part of SIBs in the US. In the future, SF would like to see individual investors participating in SIBs, or several institutions that would like to see some return on their investment, as opposed to making a donation. Generally speaking, investors in SIBs do not have purely financial motives, rather they are looking for a mix of social and financial value being created.

PFS payment structure

Under a PFS payment structure, the social investor lends money to run the project, and if the project succeeds the government will pay back the lender their principle, and certain profits will be made depending on the level of success achieved based on the target outcomes. Intermediaries always get paid a project management fee, but sometimes they will receive a small success fee from the profit made. Service providers usually do not take a financial risk because they are already taking a reputational risk, contingent on the success of the project.

Government budgets have to be approved by congress, and are implemented in the fiscal year. To budget for PFS contracts, the government needs to allocate in the budget the maximum amount that they may have to pay. If the project doesn't succeed, they can use the money or save it for other purposes.

And in the case that a project meets its target outcome, for example recidivism is reduced by the target percentage, but tax savings objectives are not achieved, the government would still have to pay. It is difficult to isolate which factor and to what extent the factor effected the change in the tax bill. As a result, the government has to pay the amount based solely on the set outcome targets.

Developing the outcome metrics

In order to develop the outcome metrics, there is not one model or formula to validate the numbers. It is different for each project, so SF develops their best estimate and asks for comments from the government, investors, the service providers and other experts and adjust the outcome metrics accordingly. To predict cost savings, SF sometimes partners with an expert on the issue area, for example a professor who has expertise about the topic in question. On a number of projects, including the New York State SIB, SF partnered with the Harvard Kennedy School Social Impact Bond Technical Assistance Lab**.** To assign a value SF not only calculates tangible monetary values, but also connects broad intangible concepts to a financially tangible figure. For example to determine the value of increased literacy, SF connects a child learning how to read to the government's future cost savings from that child finding employment and not ending up in jail. However, assigning a monetary value to an intangible subject always creates issues and controversy.

Interview at Social Finance's office

11

Data infrastructure and data management requirements for SIBs

One factor that facilitates the expansion of the SIB market is the proliferation of big data. In the past, service providers had an immature data infrastructure; they relied on rudimentary statistics to talk about their effectiveness, and were not particularly rigorous from an academic standpoint. Based on the much more advanced data infrastructure that is available today, the outcomes of individual participants over five to ten years after implementation can be tracked. This allows much more robust studies to be conducted about the actual effectiveness of interventions.

When conducting the bidding process for an SIB, the capacity to handle big data through a well-developed data infrastructure is one of the prerequisites SF looks for when selecting an organization to partner with. For the New York State SIB project for example, SF partnered with the Centre for Employment Opportunities as the service provider, who is good at tracking data. There is not a great database that evaluates and compares the data capacity of various nonprofits, but evaluations are sometimes published in a journal of social services or sociology.

SF has not had any trouble finding capable service providers so far; where one or two organizations out of ten applicants always had the required data management capacity. But because the majority of nonprofits don't have well developed data infrastructures to handle such large data sets, a lot of SF's consulting work is devoted to helping service providers establish data management and tracking infrastructure.

Setting realistic expectations for SIBs

SIBs are becoming popular in the US because state and city governments are coming under financial pressure to spend less; SIBs give governments a chance to test programs and only pay for the ones that work, thereby stretching their shrinking pool of resources while delivering effective social programs. In light of the recent popularity of SIBs and their proliferation worldwide, some skeptics are wary of a boom bubble bust scenario. In order to temper expectations, understanding the effectiveness of an intervention through rigorous analysis will help set realistic expectations and avoid inflated enthusiasm. One of the unique and powerful features of SIBs is that they really help align incentives between the public and private sectors. Hopefully the growing enthusiasm for SIBs will not turn out to be a passing fad, and effective pubic private partnerships will continue to be developed to deliver innovative and effective social programs to find new ways to address persistent social problems.

Harvard Kennedy School Social Impact Bond Technical Assistance Lab

Introduction to the Harvard Kennedy School Social Impact Bond Technical Assistance Lab (SIB Lab)[5]

The mission of the SIB Lab is to provide technical assistance directly to all levels of US governments interested in pursuing SIB initiatives. The SIB Lab will embed a fellow within the government to provide regular full time assistance with every aspect of putting together an SIB deal. The SIB Lab fellow reports directly to the government official to make sure the government official considers all the pros and cons of the proposed SIBs and makes decisions objectively. The SIB Lab fellow is usually the only employee within the government who works exclusively on the SIB deal. Their role is to ensure the project moves forward, activities are coordinated, deals are robust, and the government is getting a fair deal. Additionally the SIB Lab fellow ensures projects are designed with effective evaluation mechanisms, thorough cost-benefit analysis has been conducted, and the project can be successfully scaled up.

Ryan Gillette (left) & Hanna Azemati (right)

---

[5] Our interviewees were Mr. Ryan Gillette, Assistant Director for the SIB Lab, and Ms. Hanna Azemati, Director of Social Innovation Financing at New York State. Ryan was the first member of the SIB Lab. He had been with the SIB Lab since 2012 and had worked on three projects; one with the State of Massachusetts on a project designed to help prevent children coming out of juvenile prison system from reoffending by connecting them with services; another with the City of Chicago on a pre-school initiative that would improve the outcomes for impoverished families; and another with New York City and the State of Connecticut on a project serving children who had been abused and were in the child welfare system. Ms. Hanna Azemati joined the SIB Lab in 2012, after working with New York State Governor's Office, where she worked on the first state led SIB in the US. Hanna now works directly for the State of New York as the Director of Social Innovation Financing where she ensures the projects are operating smoothly and develops new SIBs. Two new SIB projects Hanna was working on were; one to expand an early childhood program and improve both child and maternal outcomes; and another to reduce youth incarceration in upstate New York.

Technical assistance provided by the SIB Lab fellow may include: cost-benefit analysis, financial modelling, evaluation, and briefing senior staff and other government officials. Albeit cautiously with commercial investors, the SIB Lab staff are willing to consult informally with anyone in the field; for example helping service providers design service delivery programs, or providing informal advice to intermediaries and foundations.

All of the SIB Lab's programs are targeted specifically at government agencies, and until now formal partnerships have been exclusively with US governments. By focusing exclusively on the government side of putting SIB deals together, potential conflicts of interest can be eliminated, allowing the SIB Lab to provide impartial advice on potential SIB contracts to government agencies.

Technical assistance is provided pro-bono by raising funds through foundations to cover the cost of the embedded SIB Lab fellow, and additional costs that may arise, such as having data analysts. The SIB Lab reserves about $300,000 per government that they serve. The SIB Lab's model typically covers 12 months of technical assistance to help a government; select the project they want to implement, conduct an analysis to determine if the project is feasible, go through negotiations, write a legal contract, and start to implement the project. While continuing to be available to provide advice and ongoing support, the SIB Lab leaves the service provider and other partners to run the program once implementation has begun.

The SIB Lab held annual competitions in 2014 and 2015 to select applications for technical assistance, with about 30 applications being received each year. The primary observable differences between the applications received each year were that the second year's applications were stronger, showing a clearer understanding of how SIB models work and applications proposed to address some new policy areas. Interest was shown from a variety of levels of government, including city, county, and state governments, and applicants were received from across the political spectrum.

The SIB Lab's Experience with SIBs

Four SIB projects the SIB Lab had provided technical assistance for that had launched include: the Massachusetts juvenile justice program, the Massachusetts homelessness program, the New York State recidivism program, and the Chicago early childhood pre-kindergarden program. Those projects all fell within the policy areas of including recidivism, homelessness, and early childhood education. The policy area or focus of the programs are selected for two reasons. The first reason is that the particular issue areas have to be a priority for the government to address. Since SIB projects are

difficult and time-consuming to put together, the administration has to be willing to put the time and resources into carrying the project through to completion. The second reason for selecting particular project areas is that cost savings and improved outcomes can result from completing a project, and that the results can be quickly and easily assessed. For example with the policy areas of homelessness and recidivism, a positive outcome is observed if people are living in permanent accommodation, or have not returned to jail. For some policy areas, the challenge is that it would take a longer time to see a positive outcome, so investors would have to wait a long time to see a return on their investment. In the case of early childhood education for example, an intervention may take 10 to 20 years to produce measurable results.

When determining the amount of payment for each outcome, the SIB Lab uses a cost-benefit analysis when structuring the project. The government usually pays based on estimated savings, not realized savings, for example the estimated savings resulting from someone not returning to jail. During the course of the project, an evaluation is conducted, preferably with a randomized controlled trail, to see what the outcome of the program was. Based on the estimated savings determined by the upfront cost-benefit analysis conducted, payment for each outcome is made.

In most cases, SIBs are introduced in fields where there is already a body of evidence, and often to scale up programs with a proven track record. It is difficult to try new interventions without an existing body of evidence, because investors are reluctant to invest without some assurance that the program will succeed and a return on their investment will be paid. In order to overcome this limitation and allow SIBs to foster innovation, the SIB Lab suggests including a new intervention as a separate portion of a project, which would not be tied to payments and would be funded through a separate philanthropic source. This way, an evidence base could be built on the new intervention, while evaluating the rest of the program separately. This evidence base could attract future investment in the new intervention, but without the initial risk to investors.

Besides policy area and program focus, the SIB Lab considers the scale of the project, in terms of the number of beneficiaries served and level of financing, as key considerations of an SIB project. The SIB Lab recommends the minimum scale of 400 to 500 individuals in order to have a good sample size and a robust evaluation. In terms of level of financing, projects above $15 million are more cost effective because of the high fixed costs of SIBs. In the SIB Lab's experience, investors are not interested in small projects for $3 to 4 million, rather they prefer a minimum of $5 to 6 million, and ideally $10 to 15 million.

The political landscape for SIBs in the US

While some Democrats misunderstand SIBs as a way to privatize or outsource services that should be the government's responsibility, not private investors, Republicans are interested in SIBs as a way to hold the government more accountable and reduce government spending. When Republican Representative Todd Young introduced the SIB Act in the House of Representatives, the SIB Lab reviewed the Act and thought it was good, but that it would be difficult to pass through Congress. The challenge of passing the proposed SIB Act stems both from inadequate understanding among Congress, and the difficulty in allocating the budget for that type of bill. Republicans support SIBs, but want funding for SIBs to be reallocated from existing spending, whereas Democrats will not support the re-allocation of money from other programs to support SIBs. The Obama administration had allocated $400 million to the Treasury Department to be used for SIBs, but the proposal will not be effective until the unlikely event that it passes Congress.

Interview at New York Marriott East Side Hotel

Currently the federal government makes grants to organizations such as the SIB Lab and Social Finance to help structure SIB deals, but is not directly investing or participating in any of the SIB deals. But for SIBs to be scaled up and for more projects to proliferate, the federal government needs to become more directly involved, since

SIBs are only cost effective if savings at both the federal and local levels are accounted for. For example if New York State enters into a contract and agrees to pay for a project that generates savings through reduced health spending, for savings to outweigh the costs, savings at both the state and federal level would need to be accounted for; because if a project is successful, savings are received by both the federal and state governments. But if the state government only paid for the savings at its level, the investor's costs would not be fully repaid, which is why the federal government also needs to pay for the savings received at the federal level. Currently the state government is paying for both. Consequently, an SIB is not cost effective for the state government, because it is paying twice as much as it is actually saving.

Payment considerations

Full payment for successful outcomes is often not fully realized until the end of an SIB contract. And since it is normal to enter into multi-year contracts, there is a risk that if the outcome payment money was not set aside by the government, the investors won't receive their full payment. The challenge is that state budgets typically have a single year budget cycle, besides New York State, which appropriates money and has two years to spend it.

To avert this potential risk to investors, the funds for outcome payment can be guaranteed by a full faith and credit clause, as was applied in the Massachusetts SIB[6] to guarantee the full outcome payment. A full faith and credit pledge is a legal term sometimes used when bond offerings are made, basically to guarantee payment for money owed to investors. Another solution, is that before a contract is signed and a project starts, the government sets aside the maximum amount that they could have to pay for successful outcomes into an escrow account. Investors expressed their preference for that kind of funding guarantee. Sinking funds are similar, where the government puts aside the money they will owe.

In the case of a three year SIB for example, in some cases the payment would not be made in full until after the third year, based on the results of the performance evaluation. In theory, if the SIB deal is structured correctly, the burden of paying for three years of service after the third year should be offset by the monetize-able savings generated through the service delivered through the SIB. In other words, the amount the government pays for the outcome should be equivalent to, or less than, the cost savings

---

[6] Social Impact Bonds: Lessons Learned So Far (Retrieved on 2015-08-21 from: http://www.frbsf.org/community-development/publications/community-development-investment-review/2013/april/social-impact-bonds-lessons-learned/)

from preventing the negative consequence through the social intervention.

Some governments may prefer to level out the expenditure level each year, instead of making one big payment at the end of the project. One way to achieve this is by putting aside money each year based on success achieved to date, but not actually paying until the end; and if the payments are below what the government expected to pay based on targets not being met, there would be residual funds that could be put back into the general fund. Another way to level out the expenditure level would be to make incremental success payments at the end of each year, as is done partially in the Chicago Child-Parent Center SIB[7].

Incentives and risks for stakeholders in SIBs

There are incentives and risks for all stakeholders in an SIB. Intermediaries have to be very careful how they structure SIBs, because they risk losing projects if investors become reluctant to invest because of one SIB that didn't repay investors. From the perspective of the government, the motivation to participate in an SIB is to maintain or improve social service provision, despite budget shortfalls, by providing a new supplemental funding streams. The government also benefits by only having to pay if the success targets are met, but will not have to pay if the service is not proven to work. If the project is successful, however, the government may end up paying more than the basic cost of delivering the service, because they have to cover the overhead costs and compensate the investor for the risk they assume. Another risk incurred by the government is that although the program succeeds and they have to make success payments, the cost savings are not as high in reality as was estimated. To minimize the risk of the government paying an exorbitantly high amount if the program exceeds target expectations, the contract can include a maximum total payment that the government would have to pay for the project.

The benefits of SIBs for investors are clearly understood, but the challenge in designing SIBs is how to guarantee benefits for service providers, in order to incentivize participation in projects moving forward. SIB projects may include a financial benefit if the service is successful; for example in the Massachusetts SIB the service provider receives additional payments for successful outcomes. The incentive for service providers may be in proving the efficacy of their services through the evaluation; but there is the risk that if their services are shown not to be successful they won't raise

---

[7] Child-Parent Center Pay-for-Success Initiative/SIB Fact Sheet (Retrieved on 2015-08-21 from: http://www.goldmansachs.com/what-we-do/investing-and-lending/impact-investing/case-studies/chicago-social-impact-bond-multimedia/fact-sheet.pdf)

funds going forward. Another risk for the services provider, is if the program is delivering positive outcomes, but not the outcomes which are ties to payments. In this case, investors would not get their money back and the service provider would receive a bad reputation, despite succeeding in their mission to deliver positive outcomes for their beneficiaries. Thus, it is important to align success for the investor with success for the service provider.

There are also risks associated with the evaluation. One risk for the service provider and investor is if the evaluation is not robust with a large enough sample size, the evaluation may indicate that the program didn't work even though it did. On the other hand, if the program did not work but is evaluated to have been successful because of statistical noise, the government would have to pay despite not receiving any cost savings and the program may even be scaled up based on the inaccurate evaluation.

MDRC

Introduction to MDRC

MDRC is a nonprofit, nonpartisan education and social policy research organization, created in 1974 by the Ford Foundation and a group of federal agencies.[8] The mission of MDRC is to have a positive influence on social policy that will improve people's lives. As an organization, MDRC is dedicated to doing rigorous research, almost exclusively conducting randomized controlledtrail evaluations.

David Butler

MDRC's role as intermediary of the New York City Adolescent Behavioral Learning Experience (ABLE) for Incarcerated Youth Social Impact Bond (SIB)

As a research organization, MDRC was skeptical, and initially had some reservations about getting involved in the ABLE SIB project at the Rikers Island correctional facility when they were approached by the City of New York. First of all, MDRC was skeptical about all the hype surrounding SIBs; which were being sold as new innovations in the field of social policy. Similar expectations had turned out to be inflated in the past, and MDRC wondered whether SIBs would in fact turn out to be successful and appealing to both the government and the financial sector.

Another concern MDRC had, was that they were asked by the city to participate in the SIB as the intermediary, but not the evaluator. MDRC had not been involved in social financing before, but had played the role of project intermediary and evaluator on many occasions. In this case, playing both the intermediary and evaluator roles would have created a conflict of interest, since the project's success might benefit MDRC financially, through the acquisition of new projects.

Despite the initial skepticism, MDRC ultimately decided to participate in the SIB so they could investigate and evaluate whether SIBs, or more commonly Pay for Success (PFS) in the US, really live up to the claim that they will produce positive results. In theory, SIBs could bring new money in from private sources to fund preventative efforts that would address critical issues before they escalate into bigger

---

[8] About MDRC (Retrieved on July 14, 2015 from: http://www.mdrc.org/about/about-mdrc-history)

social problems. In contrast to the way social programs are funded in the US, where programs that were funded in the past continue to get funded, regardless of actual value creation; SIBs present the potential to provide currently unavailable resources to fund startups and scale up promising ideas. Additionally, the issue area of the SIB project, reducing recidivism among young people through cognitive behavioral therapy (CBT), aligned with some policy areas MDRC had previously worked on and was interested in learning more about.

Due to the complicated nature of the SIB project, after the project's initial intermediary had not work out, the City of New York approached MDRC, who had worked with the city before on other complicated projects. Usually an open competitive bidding process would be conducted for applications, but in this case MDRC was selected on a negotiated basis because the SIB was a new initiative requiring exceptional organizational capacity, MDRC had the proven experience and capacity, and the project had to be up and running very quickly. So after being approved by the New York City Comptroller's Office and by city council, MDRC became the intermediary of the first SIB in the US.

As the project intermediary, establishing good relationships with all collaborating partners is essential; including the service providers, who deliver the intervention to the young people at Rikers Island correctional facility; and the Department of Corrections because they oversee what happens in the facility every day. By making regular site visits and speaking with staff, MDRC can learn about factors that will impact the intervention, and ensure the program is being implemented as intended. By closely monitoring how the program is being implemented, for example the number of sessions being run and the number of program participants, adjustments can be made if necessary.

The Structure of the ABLE SIB
The payment structure

Goldman Sachs is committed to lend $9.6 million to fund the SIB; a quarter of the loan is drawn down annually over four years. $9.6 million is the cost of running the ABLE program at Rikers Island correctional facility for four years; excluding costs for MDRC's monitoring and operation costs, which are covered by Bloomberg Philanthropies from a different fund

Elisa Nicoletti

under a separate arrangement.

The loan is secured by a promise to pay from the City of New York if the predetermined targets are achieved, and is also secured by a $7.2 million grant, or guarantee fund from Bloomberg Philanthropies; so Goldman Sachs is actually only risking $2.4 million at maximum, rather than $9.6 million. In any case, MDRC does not stand to lose any money. The reason the SIB was structured this way, was that Bloomberg Philanthropies had $7.2 million dollars, which was enough to run the program for three years. But they needed an additional $2.4 million to operate the program for a fourth year, which was subsequently provided by Goldman Sachs.

If recidivism is reduced by the minimum target, Goldman Sachs will be the first to receive the payment from the city. And if Goldman Sachs has not received its entire principle of $9.6 million, then the $7.2 million grant from Bloomberg Philanthropies will be used to compensate the difference as much as possible. For example, if recidivism is reduced by between 8.5% and less than 10%, the city will pay $4.8 million (half of the full loan amount), and Bloomberg Philanthropies will pay the guarantee fund, equivalent to $4.8 million. In this case, Goldman Sachs will receive their full investment of $9.6 million back. If recidivism is reduced by less than 8.5%, the city will make no payment; Bloomberg Philanthropies will pay the entire $7.2 million guarantee fund to Goldman Sachs, who would lose $2.4 million.

Ideally, if recidivism is reduced by 10% or greater, the guarantee fund from Bloomberg Philanthropies won't be used at all, and the city will pay the full $9.6 million loan amount to Goldman Sachs. In this case, the $7.2 million guarantee fund from Bloomberg Philanthropies will be used for another project; it would not be paid to Goldman Sachs.

In July 2015, the outcome report of the recidivism reduction rates from the start of the ABLE program will be released; depending on that report Goldman Sachs will decide whether they want to continue their loan or not. If the impact is equal to or over 9.0%, the program will probably continue, if below 9.0%, it will probably be stopped.[9]

If the impact is 9.0% or greater there will be a payment of $2.4 million this year, if it is less than 9.0% there is no payment. But the $2.4 million would be an early payment from the total payments and would be subtracted from the final payment. So if

---

[9] The results of the evaluation by the Vera Institute of Justice reported that the ABLE program did not reduce recidivism, so the program ended on August 31, 2015. MDRC Statement on the Vera Institute's Study of the Adolescent Behavioral Learning Experience (ABLE) Program at Rikers Island (Retrieved on July 9, 2015 from: http://www.mdrc.org/news/announcement/mdrc-statement-vera-institute-s-study-adolescent-behavioral-learning-experience)

the reduction in re-incarceration rate was 20% after the fourth year, the city will pay $11,712,000 minus the $2.4 million that was already paid. (See the Savings and Payment Chart below, outlining city payments and projected savings according to reduction in recidivism rates.)

Table 1. Savings and Payment Chart[10]

Reduction in Re-Incarceration Rate	City Payment to MDRC ($)	Projected Long-Term City Net Savings ($)*
≥20.0%	$11,712,000	$20,500,000
≥16.0%	$10,944,000	$11,700,000
≥13.0%	$10,368,000	$7,200,000
≥12.5%	$10,272,000	$6,400,000
≥12.0%	$10,176,000	$5,600,000
≥11.0%	$10,080,000	$1,700,000
≥10.0% (breakeven)	$9,600,000	$ ≥ 1,000,000
≥8.5%	$4,800,000	$ ≥ 1,000,000

Savings after repayment and continued funding for program delivery.

The final payment to be made in 2017 is based on two years of recidivism reduction, so the full payment can only be made if the program operates for a fourth year. One year results will be known by July 2015, and two year results will be known in July 2016, but the City of New York won't pay until July 2017. The delay in payment is supposed to give the city time to realize the cost savings associated with having fewer people in jail. The payment in 2015 is like an early payment, and the one year impact results will determine whether or not the program will run for a fourth year. If the program is discontinued in the summer of 2015 due to the target outcomes not being met, there will be no final payment.

---

[10] Fact Sheet: The NYC ALBE Project for Incarcerated Youth (Retrieved on July 9, 2015 from: http://www.nyc.gov/html/om/pdf/2012/sib_fact_sheet.pdf)

Although it is an unlikely scenario, even if the one year impact results released in July 2015 do not meet the minimum target and there is no payment, Goldman Sachs could choose to continue to a fourth year. Theoretically, if Goldman Sachs chose to continue and the impact after two years was 8.5% or greater, they would still receive the payment for that success. This theoretical case is highly unlikely, since the investors would likely stop the loan and would not pay to run the program until the fourth year.
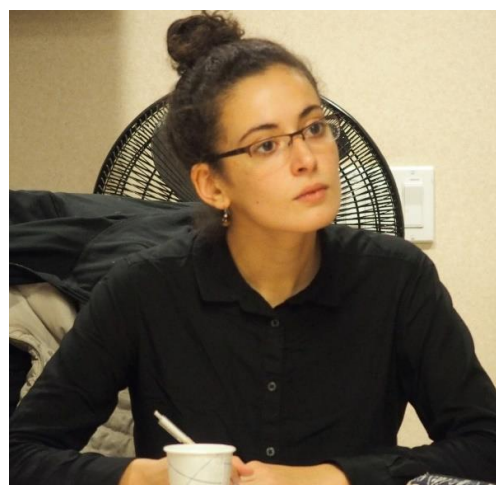
Mariana Veras

Another possible scenario is that if the outcome does not meet the minimum target but the ABLE program is shown to be a cost effective program, the city may choose to continue the program regardless of whether or not Goldman Sachs continues to invest.

Formulating the payment framework and outcome metrics

The payment framework and outcome metrics were formulated by MDRC and the City of New York, who structured the contract; then MDRC approached banks to secure a loan. To determine achievable target outcomes, research on CBT for incarcerated populations was conducted, which indicated that recidivism rates could be reduced by between 10 to 20%. Based on the research of successful programs, MDRC determined the amount of money that the city would need to save to achieve their budget outcomes.

MDRC and the city took the lead in analyzing the data and coming up with the SIB model, but all partners, including Bloomberg Philanthropies and Goldman Sachs, agreed to the terms after requested changes were accommodated. As the project intermediary, MDRC had to strike a balance between the contrasting opinions from the City of New York and Goldman Sachs with regards to the payment scale. In particular, the city thought that there should be no, or a very small amount of interest on the loan; and that there should be one level of success payment. On the other hand, Goldman Sachs thought that there should not be a cap on success payments, and that smaller levels, even an 8% reduction in recidivism, should receive some compensation. In the end, additional payment levels at 8.5% and 20% were added as a compromise between

the opposing positions.

To determine the outcome metrics, a randomized controlled trial was tried; randomly assigning half of the population to the program called the treatment group while the other half was the control group. This method proved not to be possible since the adolescent inmates are frequently moved between different housing units at Rikers Island jail, which would have confounded the treatment and control groups[11]. As an alternative, the evaluation committee and the evaluator selected an experimental comparative design. The primary comparison group comprised of young men in Rikers jail, in the same age range of 16 to 18 years, but from five years previous. In addition, the outcomes of 19 year olds were looked at, contemporaneous to the program group; since 19 year olds were thought to have similar outcomes to 16 to 18 year olds but were not eligible to receive ABLE services. The outcome metrics were formulated by comparing the outcomes of those two groups to determine what targets could be reasonably achieved.

Lessons learned from the ABLE SIB
Changing conditions require flexibility in the contract

One lesson MCRC learned from the ABLE SIB experience, is that besides reaching the target impact, reaching the target number of participants is equally important. Typically, when judging a project's success, the evaluator looks at the impact of the program; in this case the percentage of reduction in recidivism. But when cost savings determines the success of the project, then the scale of the target, in terms of numbers, is equally important to the impact. This was not an issue MDRC had fully considered in the project design, and they found that since the number of people entering and leaving the jail was beyond the control of the stakeholders, the targets they set may not have been achievable based on the real numbers of people in the jail; which had declined by over 30% over three years. Specifically, the contract requires MDRC and the service providers to receive 2,500 people this year, but there is not 2,500 people in the age cohort. The consequence of MDRC and the service providers not serving the required number of people is that the payments would get reduced proportionally. The important lesson to be applied in future projects, is that the terms of the contract have to allow enough flexibility to adjust targets so that they are achievable based on real circumstances.

---

[11] Impact Evaluation of the Adolescent Behavioral Learning Experience (ABLE) Program at Rikers Island (Retrieved on August 4, 2015 from: http://www.vera.org/sites/default/files/resources/downloads/adolescent-behavioral-learning-experience-evaluation-rikers-island-summary-2.pdf)

Plan for costly monitoring and data capacity requirements

The ABLE SIB illustrated the tremendous data capacity requirements; not to mention the associated costs; above and beyond what is usually required by organizations. MDRC performs monthly monitoring of the ALBE program so they can observe what is going on. To administer such costly and robust levels of monitoring and due diligence, Bloomberg Philanthropies provided grant funding; an aspect of the project that MDRC felt would probably not be replicated in other projects. A lesson learned from this experience was that in future deals there must be enough money available to perform adequate level of monitoring.

Elisa Nicoletti (left), David Butler (center) & Tim Rudd (right)

Final reflections

After the three years that the ABLE SIB has been operating, the lessons learned will undoubtedly have a great impact on the future of SIBs and on the social service field as a whole. While the roles in SIBs for the service provider, investor and intermediary are variable and change and evolve with the market; it is difficult to imagine SIBs without participation from the government, who clearly reap several benefits. One benefit is risk reduction where the government doesn't pay for a program that doesn't work, similar to an insurance policy. Another benefit is that the government is essentially getting an inexpensive loan to immediately start a social program but pay for it in the future, after savings have been achieved that will offset the costs.

While the social service sector as a whole should benefit from the tremendous

amounts of data being generated through monitoring and evaluation requirements of SIBs, one unfortunate limitation of project evaluation in the context of social finance is that the project's success is only measured based on cost savings. This shortcoming is highlighted in the ABLE SIB; since the evaluation is not funded to look at other residual benefits, the ABLE program's full impact will be not fully understood outside the narrow scope of recidivism reduction.

The Rikers Island jail is an infamously challenging environment to successfully implement the proposed intervention, with abuse by correction offices against adolescent inmates being frequently reported[12]. MDRC felt that the conditions in the jail made it difficult to run the program well, but that the project was well received and supported by city managers, political forces and heads of the corrections agency, since it was something positive happening in a place so mired in scandal. Regardless of the ABLE SIB's final outcome, in terms cost savings, return on investment, or levels of recidivism reduction, the connections made, lessons learned and publicity generated will hopefully lead to broader reforms within the Rikers Island jail system and lead to improved conditions and better long-term outcomes for the young inmates.

---

[12] New York City Settles Suit Over Abuses at Rikers Island, The New York Times (Retrieved July 8, 2015 from: http://www.nytimes.com/2015/06/23/nyregion/new-york-city-settles-suit-over-abuses-at-rikers-island.html?_r=0)

The Institute of Nonprofit and Public Management Studies (INPMS)