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Finding funding to sustain and scale up successful initiatives that address critical social issues is a paramount concern for government and foundation funders and for nonprofit leaders. Public agencies and philanthropies seed innovative social programs and services, but frequently they are unable or unwilling to invest at the requisite level to effectively scale up proven approaches to meet identified needs. Although evidence-based programs may have demonstrated significant positive impact and cost-effectiveness, the foundations that funded their development and testing often lack the resources to expand these efforts beyond their small-scale origins. Moreover, while government administrators have the required resources, they often face significant barriers to reallocating funding from existing remedial programs to new ones that have greater potential to prevent serious social problems. In recent years, a growing number of philanthropic foundations, policy makers, social service providers and researchers have come to realize that the social sector is changing. Shrinking public-sector budgets have limited grant programs, while enterprising and innovative nonprofit organizations often have limited capacity to expand the reach and effectiveness of their programs and services.

Against this backdrop, many public- and private-sector leaders are actively searching for new models of partnership between the public, nonprofit and private sectors that focus the financing of high-quality programs and services on achieving results by:

- providing strong incentives and support for scaling up
- yielding positive results for children, families and communities
- providing tangible returns to taxpayers and other investors
Increasingly, the most innovative financing strategies aim to create positive social change and produce measurable financial gains. Many of these strategies link funding to desired outcomes. Some, such as social impact bonds, are structured to reinvest the savings achieved through cost efficiencies in expanded community supports and services. Others, including performance-based contracts, are structured to reward programs monetarily for producing measurable results. In both cases, the goal is to provide positive incentives for performance.

**Background**

In 2009, The Nemours Foundation and The California Endowment along with an anonymous donor launched the Children’s Outcome Project (COP), an initiative of eight states and local communities to implement multi-sector, place-based approaches to address pervasive challenges facing children and families in low-income communities. Cities across the country have implemented similar approaches with demonstrated success including improved mental and physical health, increased parent engagement and school readiness. A key factor in the success of these initiatives has been the presence of an effective intermediary organization. For the COP sites, these intermediary organizations are public-private or quasi-public agencies that provide funding and organizational support to community-based organizations that in turn provide direct services to target populations in their communities. Intermediary organizations are a crucial component of the multi-sector, place-based approach because they coordinate and align services and interventions. However, securing funding for intermediary organizations can be difficult, particularly in the current economic climate and the stated preference of many funders to support direct services rather than organizational infrastructure and capacity.

The Children’s Outcome Project focused not only on implementing multi-sector, place-based strategies, but also on identifying innovative approaches to financing and sustaining the grantees’ work in their communities. Incentive-based financing strategies present promising avenues for financing and sustaining multi-sector, place-based approaches. While the most robust examples of state and community implementation of these strategies are in the areas of adult and juvenile crime prevention, child welfare and employment and job training, there is growing attention to opportunities to expand into early child care, education and health systems.

Based on the collaborative work of COP grantees and lessons learned from their experiences, this strategy brief discusses three alternative incentive-based financing strategies, including key elements that need to be in place to support the implementation and success of each approach.
Incentive-Based Financing Strategies

- **Public-private partnerships** are strategic connections between the public sector (e.g., federal, tribal, state, or local government officials and agencies and schools) and the private sector (e.g., philanthropies, civic groups, service providers, and community-based organizations) to pursue shared social goals.

- **Performance-based contracting** is a financing strategy that ties government payments for contracted services to performance benchmarks reached by the contracted providers.

- **Pay-for-success models** tap private sector funding for up-front program or capital investments. The investments aim to build community capacity for comprehensive supports and services in order to help vulnerable children and families overcome social problems and avoid the need for more-costly, deep-end interventions and treatment. Savings can then be reinvested in expanding community capacity and/or repaying private-sector investors a return on their initial investment.

Challenges to Incentive-Based Investment

Public and private funders face important challenges in crafting accountable but flexible incentive-based financing strategies. Among the most significant barriers are regulatory restrictions on government funding. The largest sources of public funding are directed to deep-end services, including foster care, criminal justice and public subsidy programs such as food stamps, rather than to prevention and family support services. Some of these funding sources, such as the Title IV-E Foster Care and Adoption Assistance program that provides critical support to children who are placed with families in foster care, encourage the use of more-expensive service options by restricting funds from paying for prevention and less intensive community-based programs that keep children in their homes.

Additionally, in a time of scarce resources, many funders want assurances that their investments will make a positive difference at a reasonable cost. Without documented evidence of long-term positive outcomes for clients of many social programs, it may be difficult to convince investors to get behind new social innovations. Investors may also be reluctant to embrace new strategies for incentive-based investing that have not been widely implemented, tested and refined.

Despite these challenges, the federal government and a growing number of states are exploring program financing models that “pay for success.” For example, Minnesota has issued state bonds to raise $10 million to support and scale up the most effective programs that produce a net benefit to taxpayers. The U.S. Department of Labor’s Employment and Training Administration made $24 million available to create pilot Pay-for-Success projects. Washington State is taking steps to convert all contracts for child welfare services to pay-for-performance contracts. These initiatives demonstrate different approaches with a common purpose of changing the way social services programs are financed and scaled up. Despite their differences, all strategies aim to achieve greater social impact at a reduced cost in the long term.
Mobilizing new capital or increasing the effectiveness of current funding to maximize desired social outcomes is a new concept of growing interest to public and private sector leaders. Though interest in incentive-based investment is increasing, existing knowledge is based more on theory than on empirical data and practical experience. Accordingly, this brief aims to help policymakers, community leaders, private investors and other stakeholders understand what is known about the opportunities and conditions for success in designing and implementing incentive-based financing strategies to take innovative evidence-based social solutions to scale. It describes the design and implementation of three broad types of innovative financing strategies that make funding contingent on specific benchmarks for success:

- spurring innovation and investments through public-private partnerships
- tying resources to outcomes through performance-based contracting
- structuring private capital and government funds to support pay-for-success financing models (e.g., social impact bonds)

These strategies differ in their complexity, in how they are structured, and in how risk is shared among investors and partners. Yet all of them have significant potential to create greater value in the social sector by overcoming barriers to the growth of proven social initiatives, such as poor cash-flow management, fragmented demand and demand uncertainty. In return for achieving positive outcomes, community leaders and program managers may receive additional funding, have the authority to reinvest cost savings in expanded social programs, or gain greater flexibility in how they may use available funds.
Strategy 1: Spurring Innovation and Investments With Strategic Public-Private Partnerships

Overview

Public-private partnerships are not new. Private foundations have long been interested in partnering with government agencies, so their initial investments in program development and testing can be sustained through funding provided by large, stable public programs. Yet the recent economic climate has created greater urgency for public and private sector leaders to work collaboratively to address social, economic, political, administrative and other conditions that may impede healthy child development, strong families and thriving communities. For example, employers increasingly acknowledge that workforce readiness depends on high-quality services and programs in preventive health and early care and education in addition to stellar K–12 and postsecondary education systems.

Public-private partnerships bring public agencies (e.g., federal, tribal, state and/or local government officials and agencies, schools, etc.) together with private organizations (e.g., philanthropies, civic groups, community-based service providers, etc.) to address complex social problems and develop solutions that can be sustained over time. However, new models of strategic public-private partnerships are more selective, more targeted and more intensive than those of the past. They place more emphasis on a clear and common agenda for social change and shared responsibility for achieving goals and outcomes. Strategic public-private partnerships align or pool public and private funds to create win-win strategies that share the risks and the rewards of addressing critical social concerns. For example, public-private partnerships to support vulnerable youth typically focus on ways to improve and expand the capacity of schools, neighborhoods, communities, service providers or the state to meet the multiple, inter-connected needs of young people and their families.

Public-private partnerships differ depending on the purpose, partners and funding mechanisms, but essential characteristics of strategic and successful partnerships include:

- **Common goals.** Leaders from the public and private sectors coalesce and work towards common goals and objectives.
- **Committed resources.** The partners contribute time, money, expertise and/or other resources to the partnership.
- **Shared responsibilities.** The partners share decision-making and management responsibilities. They also share accountability for achieving desired outcomes.

### How It Works

A public-private partnership exists when public leaders, including federal, tribal, state or local government officials and agencies, connect with private-sector community leaders, including families, employers, citizens, philanthropies, the media, civic groups, service providers and community-based organizations, to pursue shared goals for improving the quality of life and outcomes for residents of the community. Public-private partnerships have been formed to meet the diverse array of social challenges facing children, youth and families. Among the COP grantees, public-private partnerships have been designed to address the critical needs of young children and their families and to promote school readiness. COP grantees also focus on ways to improve and expand the capacity of schools, neighborhoods, communities, service providers or the state to avoid the problems associated with youth risk taking and to promote academic success, post-secondary school readiness and career readiness.

Recently, public-private partnerships have been created in several states and communities to address childhood hunger, including initiatives to increase access to public subsidy programs such as the Supplemental Nutrition Assistance Program.

Public-private partnerships differ depending on the purpose, partners and funding mechanisms, but strategic ones share these characteristics:

- Leaders from the public and private sectors coalesce around shared goals.
- The partners contribute time, money, expertise and/or other resources to the partnership.
- The partners work together toward common goals or objectives.
- The partners share decision-making and management responsibilities.
The most notable of these types of public-private partnerships are to be found in federal innovation funds, established to help nonprofit organizations secure sufficient funding to support the rigorous impact evaluations required to take a social intervention from promising to proven.

The Social Innovation Fund, created in 2009 and housed at the Corporation for National and Community Service (CNCS), invites applications from intermediary organizations with strong track records of finding and funding effective social service organizations. Through a competitive process, the Social Innovation Fund makes grants of $1 million to $10 million per year for up to five years. Investments are at two significant levels:

- investments in intermediaries who can find the best, most innovative social service programs nationwide
- investments in scaling programs that are already working

The federal grants then leverage private and philanthropic dollars twice: first the intermediaries must match the federal grant 1:1. Then the grantees who receive funds from the intermediaries must likewise match their awards 1:1. The funds are used to scale effective social services so they can reach more people in need. They also can be used to finance rigorous evaluations. The program also supports technical assistance on evaluation.

The programs and projects assisted through the Social Innovation Fund are geographically and programmatically diverse. The Fund supports early childhood programs in Minneapolis, St. Paul, Detroit and several cities and towns in Colorado. It provides nonacademic support to help 4,400 college students stay in school in Chicago, Miami, New York City and San Francisco. It also supports workforce development programs in Atlanta and Baltimore.
On another front, the National League of Cities’ Institute for Youth, Education and Families, in partnership with the Walmart Foundation and Food Research Action Center (FRAC) worked with 15 cities to build public-private partnerships, including leveraging federal reimbursements, to address childhood hunger by increasing participation in afterschool and summer meal programs offered through the Supplemental Nutrition Assistance Program (SNAP). Teams of city officials and key stakeholders attended a two-day leadership academy to learn more about strategies other cities have implemented to increase access to afterschool and summer meals. City teams that participated in the academies were eligible to apply for additional funds as well as training and technical assistance to increase access to afterschool and summer meals over a one-year period. As a result, cities such as Omaha, Nebraska, and Las Vegas, Nevada, have significantly improved access to meal programs funded through SNAP.

**Challenges to Overcome**

Among the important challenges for leaders and partners to overcome in using public-private partnerships to support innovation are the following:

- changing ingrained practice in community-based organizations and public agencies
- understanding that partnerships involve giving and getting – all partners bring resources to the table and all realize benefits from collaboration
- aligning multiple efforts to reduce duplication and overcome gaps in programs and services for needy children and families
- ensuring accountability among all partners on an equitable basis
Strategy 2: Tying Resources to Outcomes Through Performance-Based Contracting

Overview

Performance-based contracting (PBC) is a financing strategy that ties government payments for contracted services to performance benchmarks reached by the contracted providers. PBC has roots in the federal government reform efforts of the early 1990s, including the Government Performance and Results Act. State and local efforts to implement PBC over the years have met with varied success. Yet, while PBC has long been considered an important tool by government reformers, relatively few states or localities have successfully implemented performance-based contracts on a large scale. In fact, a 2010 survey of more than 9,000 nonprofit human services organizations found that just 17 percent worked under any type of performance-based contract agreement, and it is likely that far fewer actually tie payments to performance. By employing PBC, government agencies and private organizations can contain and/or reduce the cost of services. This type of payment creates incentives to shift away from inputs (items purchased) or outputs (number of clients served) and focus on achieving outcomes (improved health status or academic achievement). Key elements of PBC include:

- **Defining clear performance measures.** Because funding is tied to performance, it is crucial to clearly define successful outcomes and measurable indicators of progress.

- **Tying payments to specific outcome measures or milestones.** Performance-based contracting requires that payments are made based on achieving clearly delineated milestones or benchmarks toward predetermined outcomes.

- **Providing incentives for performance and/or penalties for poor performance.** Although payments can be structured differently depending on the contracting model, most performance-based contracts have incentives for achieving specific measurable outcomes.

- **Allowing additional flexibility.** Unlike traditional contracts, PBCs have added flexibility, such as allowing the contractor to move resources among line items to more quickly respond to changes needed to meet goals.

Performance-based contracting models vary based on how payments are structured, including the extent to which incentives or penalties are included; the time frame for measuring outcomes; the timing and amount of payments linked to those outcomes; and the process for developing performance measures, including how input is gathered from key stakeholders such as providers.

How It Works

Unlike other strategies discussed in this brief, there is no implicit requirement to capture and reinvest savings as part of performance-based contracting, though the two can be linked. Also, though performance-based contracting may involve leveraging public and private partnerships, including raising private capital, this is not a prerequisite to implementing this strategy, as with pay-for-success strategies. Many states and localities have made some progress toward measuring the outcomes of programs and services provided by human services agencies, but few have effectively tied those outcomes to funding for contracted services. Great interest in this approach is emerging in child welfare contracting. The following examples are documented in a paper prepared by Mary Myslewicz for Casey Family Programs.¹²

MODEL #1: FLORIDA PERFORMANCE REPORTING METHOD

Low Contractor Risk
States with similar models: Maine

A 1998 statute mandated the Florida Department of Children and Families (DCF) to privatize foster care and all related services throughout the state by 2003. As part of this strategy to reform child welfare services, the legislature also passed a law requiring all DCF-contracted client services to establish performance measures and standards to be achieved by the providers. The primary force behind Florida’s shift to performance-based contracting was a concurrent national movement towards performance-oriented government.

Under this model, the department’s role has shifted from primary provider of services to purchaser of services. As of December 2005, DCF had about 500 contracts with a wide range of providers for direct care services including case management, foster care placement, and substance abuse and mental health services. (OPPAGA, 2006). The performance indicators are negotiated each year and included in the contract.

Florida DCF does not directly tie contractor compensation to performance, but it does tie performance of the providers to contract renewal. The contractors that fail to meet their performance standards first receive technical assistance by the agency. If they continue not to meet expectations, their contracts may be terminated. Performance contracting in Florida is therefore designed to hold the providers accountable for their performance through the threat of contract termination.

Highlights of the Florida Model include:

- Performance measures (output, quality, outcome) are built into contracts and reported on by contractors.
- Contractor baselines for each of the performance measures are determined and then service level targets are negotiated or predetermined by DCF.
- Contractors are required to track and report on these measures.
- Contract extension is tied to level of accomplishment but compensation is not.
- There is low contractor risk because cost reimbursement continues to be primary payment.

Examples of Contractor Performance Measures and Standards:

**Child Abuse Prevention**

- percent of families who complete child abuse prevention programs 96% of 3+ months who are not abused/neglected within 12 months
- per capita child abuse rate 23/100

**Child Protection**

- percent of children reunified within 12 months 76%
- number of investigations not completed after 60 days 0
- percent of foster children who were subjects of reports of maltreatment 1%
In 1997, Kansas became the first state in the nation to fully privatize its adoption, foster care and family preservation services. Kansas’s Department of Social and Rehabilitation Services (SRS), previously the state’s largest provider of adoption and foster care services, is now strictly a purchaser of services and contract monitor with respect to child welfare services. The goal of implementing PBC in Kansas was to decrease the amount of time that children spent in foster care.

Kansas’s original managed care approach to PBC was one of the most innovative approaches taken by a human services agency at that time. Under this approach, contractors were paid a one time, up-front or capitated, fee per child. Contractors were then required to provide all services needed until the child exited care and the case was closed. Adoption providers, for example, were paid a fee of $18,000 for services. This provided a strong incentive to place the child for adoption as quickly as possible. In order to avoid perverse disincentives, the SRS also included quality standards in the contract.

Although initial findings revealed that outcomes achieved by the contractors equaled or exceeded the contract requirements, many of the contractors lacked the accounting systems to estimate the true cost of the services. This resulted in severe financial problems that pushed some agencies to the brink of bankruptcy. In this case, the contractors did not have the capacity to manage adequate service provision.

As a consequence of the financial challenges, SRS switched to the milestone approach for PBC.

Highlights of the Milestone Model include:

- Contractors are compensated at a fixed rate for the accomplishment of specific milestones.
- Contractors may incur loss if they do not meet milestones for a particular client.
- Agency can control amount of risk by including a mix of performance milestones and non-performances (input and process), as well as varying the weight assigned.

A case rate (based on average cost of care) was negotiated with contractors who received a proportion of that case rate, known as a progress payment, when they accomplished any of the four major milestones. In the case of Kansas, only one of the milestones was performance related, and the other milestones were essentially process measures. Agency performance on these measures determines whether or not contracts are renewed.

Example of Milestone Method:

**Milestone Case Rate**

1. Child referred to contractor (process) 25%
2. 60-day report to state (process) 25%
3. 180-day report to state (process) 25%
4. Child achieves permanent placement (outcome) 25%
MODEL #3: WAYNE COUNTY, MICHIGAN

Moderate Contractor Risk

Foster care providers participated in a pilot PBC initiative in 2000. The providers agreed to be paid a reduced administrative per diem rate along with an up-front initial per child payment and additional bonus payments when certain milestones were reached.

Example:

- Initial payment
  $2,210
- Placement with parents, family members, guardian or IL within 270 days
  $1,900
- Sustained placement of 6 months
  $1,290
- Sustained placement of 12 months
  $1,600
- Termination of parental rights within 515 days
  $1,900
- Adoption within 7 months of Termination of Parental Rights (TPR)
  $1,290

MODEL #4: MICHIGAN “OUTCOME REIMBURSEMENT SYSTEM” METHOD

Moderate Contractor Risk

For many years, Michigan has contracted out its adoption services, although historically performance measurements have been more process than outcome oriented. In 1992, it began a program that rewarded agencies with different payments based on the speed with which they made the placement. Under this model, providers are rewarded for achieving outcomes, or for unique recruitment efforts.  

According to the Michigan DHS website, the reimbursement levels are as follows:

- Residential Rate (placing a child for adoption directly from residential care within 120 days) $10,000
- MARE (Michigan Adoption Resource Exchange) Rate $9,325
- Five-Month Premium Rate $8,660
- Enhanced Rate (adopted within 7 months of TPR) $6,520
- Standard Rate (adopted within 7 months of wardship) $4,160

MODEL #5: ILLINOIS CASELOAD METHOD

Major Contractor Risk
Jurisdictions with similar models:
Philadelphia, Massachusetts

In response to the large numbers of children in out-of-home care in the early 1990s, officials in the Illinois Department of Children and Families decided to implement performance-based contracting for child permanency placement services, including reunification, adoption and subsidized guardianship. The principle behind the Illinois approach was to improve child permanency outcomes by managing contractor caseloads.

In this model, agencies under PBC are required to accept a certain percentage of their caseload in new referrals, and move a percentage to permanency every year. If the agency exceeds case closure expectations, an agency could reduce caseloads without a loss in revenue.

Contractors that do not close the appropriate number of cases must continue to provide care and services without additional payment.

The following three examples illustrate the incentive structure:

Current Caseload; New Referrals; Case Closed; New Caseload

- Ex 1 Baseline 24% 24% Same
- Ex 2 Baseline 24% 15% Increase 9%
- Ex 3 Baseline 24% 30% Decrease 6%

MODEL #6: NORTH CAROLINA OUTCOME MODEL

Major Contractor Risk

Officials in North Carolina decided to implement the PBC outcome approach to adoption services in 1999. This type of model constitutes a major financial risk for providers since it ties compensation directly to the achievement of specific outcomes. The providers are paid percentages of an “average placement cost” at certain milestones. If they do not meet these outcomes, they will not receive compensation.
Example:

**Outcome Average Placement Cost**

1. Child placed for adoption 60%
2. Adoption finalized 20%
3. Adoption intact for one year 20%

These models suggest that, when it is done well, performance-based contracting can be a useful tool to link outcomes to funding for child welfare programs. Additionally, the PBC focus on paying for the achievement of specific outcomes helps build capacity to effectively implement more rigorous strategies, such as social impact bonds or pay-for-success contracts.

While this strategy originated nearly two decades ago, large-scale implementation at the state and local levels have produced varying success. In 2011, the National Quality Improvement Center on the Privatization of Child Welfare Services issued a final report on the use of performance-based contracts in quality assurance systems. Researchers learned that, “A successful PBC that leads to improved outcomes for children and families requires more than just collaboration and a contract. The ways in which the public agency changes policies and procedures, such as contract monitoring, to adapt and support this new contractual relationship are important. Equally important are the ways in which private agencies create innovative strategies or systems to help them achieve their contract outcomes and provide quality services.” In this evaluation, researchers found that the percentage change in performance and quality was significant in three separate study sites after one year of implementation of PBCs.

**Challenges to Overcome**

Among the significant challenges that funders and contractors must overcome to be successful are the following:

- defining clear and relevant performance measures with a reliable set of data on which to set benchmarks so that agency leaders and contractors are in clear agreement concerning performance goals and terms for payment
- maintaining a robust procurement process and capacity to provide sufficient oversight and support for contractors
- allowing contractors additional flexibility to move resources to respond quickly to conditions that affect their ability to meet established goals
- obtaining broad-based support from an intermediary on industry standards for performance
- maintaining strong internal controls and performance management systems in contractor organizations to track required benchmarks and respond quickly to indications that performance targets will not be met

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17. Ibid.
Strategy 3: Structuring Private Capital and Government Funds to Support Pay-for-Success Financing Models

Overview
Pay-for-success (PFS) is an emerging financial model that links program funding to measurable outcomes for vulnerable children, families and communities and rewards high performance and accountability. Also known as social impact bonds or contracts, PFS has generated significant interest and excitement among funders, community leaders and social program planners. It is an innovative strategy that allows government and private funders to work differently by identifying, rewarding and scaling up successful programs.

How It Works
Pay-for-success financing taps private-sector funding for up-front capital investments. The investments aim to build community capacity for comprehensive supports and services in order to help vulnerable children and families overcome social problems and avoid the need for more costly, deep-end treatment services, residential care and incarceration. Savings can then be reinvested in expanding community capacity and/or repaying private-sector investors a return on their initial investment.

PFS offers states and local communities several important advantages. These include:

- **Scaling Up What Works.** With appropriate capacity to rigorously collect and analyze data on costs, outputs, benefits and outcomes, PFS can be an ideal vehicle for investing in and scaling up proven, evidence-based interventions.

- **Focusing on Prevention.** Because most federal programs fund treatment and remediation rather than prevention, many state and local agencies must fund prevention efforts on their own. Through PFS funding, state and local agencies can provide up-front investment to identify and scale up effective early interventions. It can also help state and local agencies shift incentives from deep-end services to community-based supports and services that reduce the need for intensive intervention, thereby maximizing long-term cost savings.

- **Supporting Efficient Government.** Through a unique partnership involving government, service providers and private investors, PFS rewards programs that meet targeted performance outcomes, while sharing the financial risk among the partners. It is also an opportunity to fund proven programs thereby ensuring public spending on social programs is efficient and yields positive outcomes.

- **Providing Incentives for Performance.** Through positive incentives for efficiency and effectiveness, PFS models are a powerful vehicle for implementing systemic change. By creating monetary incentives, government agencies, private funders and nonprofit organizations are encouraged to invest in developing and scaling up proven, high-quality interventions. Service providers also operate more efficiently because they realize cost savings. Ultimately, the visibility of successful programs in turn will attract further investment creating a stable and sustainable funding path.

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A great deal of attention and interest has focused on two variations of social impact bonds/contracts:

- In the first instance, states and/or private investors use their own revenue and resources to pay for services expected to yield positive results and savings.
- In the second instance, states raise revenues incrementally to pay for contracts to provide services.

In either case, states generally rely on an intermediary organization to manage the performance contracts among stakeholders, raise up-front working capital from philanthropies or other private investors, and distribute funds to service providers or require service providers to raise up-front working capital themselves and frequently assume the financial risk.  

The impact bond concept was developed in the United Kingdom, where the first social impact bond was launched in 2010, to combat recidivism among short-term, nonviolent offenders at Peterborough Prison.  

Since then, the United Kingdom has built an impressive ecosystem of public and private sector organizations to facilitate social financing arrangements and social impact bonds. In the United States, although Congress has not taken up any of the Obama Administration’s pay-for-success proposals, growing interest in social impact bonds has led to two federal programs. The Workforce Innovation Fund in the Department of Labor seeks to identify and evaluate promising approaches to workforce development, and the Second Chance Act in the Department of Justice funds programs to help prisoners reintegrate into society. Both have sufficient flexibility to help support pay-for-success without new appropriations. In 2013, the Justice Department awarded about $10 million in research and implementation grants for these projects, and the Department of Labor committed $24 million in grants to the state-level labor agencies in New York and Massachusetts that will be released in installments based on whether the grant outcomes are achieved.
Despite limited federal support, many states and municipalities are moving to explore and implement social impact bonds.

- The first social impact bond in the nation was announced in New York City in August 2012, with the aim of reducing recidivism among 16- to 18-year-old males imprisoned in the Riker’s Island prison complex by at least 10 percent over four years. It was financed primarily with $9.6 million from Goldman Sachs and guaranteed by a grant from Bloomberg Philanthropies for $7.2 million — 75 percent of the total investment. The guarantee means that if the outcome is not achieved and recidivism does not fall by the projected amount, the investor — Goldman Sachs — will not lose its principal.\(^{22}\)

- At the same time, the state of Massachusetts announced the counterparts it had chosen to negotiate with on two social impact bonds, one in juvenile justice and the other in chronic homelessness following an open procurement process. At the same time that the procurement was announced, the state became the first to pass legislation related to Pay-for-Success. In January 2012, Governor Deval Patrick signed legislation establishing a Social Innovation Financing Trust to hold outcome payments for the duration of social impact bond deals, thereby ensuring investors that, even with a change in administration, they will be paid for successful outcomes.\(^{23}\)

- In Salt Lake City, Utah, the United Way announced the expansion of the highly successful Utah High-Quality Preschool Program to expand high-quality early childhood education to an additional 3,700 low-income 3- and 4-year-olds in two school districts was finalized in June 2013. Goldman Sachs and the JB Pritzker Family Foundation provided a combined $6.6 million private capital, in the form of loans, to implement additional co-horts of the program. Pay-for-success payments will be made to investors based on the increased level of school readiness and decreased use of special education services by children who complete the program. Program advocates anticipate the potential savings due to decreased enrollment in special education services and remediation to be significant.\(^{24}\) The tiered investment structure is thought to be more replicable than the high-guarantee model used for the Riker’s Island project, as philanthropic investors with a higher tolerance for risk can blend resources with more risk-averse institutional investors.\(^{25}\)

- Finally, in Fresno, California, where one in five children has asthma, a pilot program funded by the California Endowment seeks to demonstrate that a social impact bond can considerably reduce the rates of asthma-related emergencies among low-income children. This grant-to-social impact bond model gives a promising candidate for full social impact bond financing time to collect data and work out issues in the delivery model before scaling up.\(^{26}\)

\(^{23}\) Massachusetts Department of Administration and Finance, “Massachusetts First State in the Nation to Announce Initial Successful Bidders for Pay for Success Contracts.” Press Release, August 1, 2012.
\(^{26}\) Ibid.
These four projects provide considerable insight into the potential for variation in the generic social impact bond model. They also highlight the fact that there is no single right approach to designing and negotiating a social impact bond. Other states and municipalities also have announced their intention to pursue social impact bond financing for social programs and initiatives, including New York, South Carolina (introduced legislation in 2013), Ohio (Second Chance grant) and Connecticut (passed legislation enabling the state to enter into social impact bond contracts, June 2012). These projects are all in early stages of development with support from the Harvard Kennedy School of Government Social Impact Bond Lab.

**Challenges to Overcome**

Not every program is a good candidate for being scaled up through social impact bonds. Among the challenges that investors and community leaders must overcome are the following:

- acquiring capital and public will to make up-front investments in building capacity to deliver all needed services and support to prevent the need for incarceration, remediation and costly deep-end services
- distribution of risk among public agency, private nonprofit and philanthropic partners so that it is worth everyone’s while to participate
- having a specific, measurable outcome and sufficiently robust outcome data to effectively measure impact and calculate return on investment, including sufficient historic data
- having a clear agreed-upon baseline from which the plans of the investors and the service providers proceed and work together
- matching the financing model to the intervention — PFS is not appropriate for addressing every social problem, especially those that require very long periods of time to demonstrate measurable results
- finding the right intermediary organization to manage multiple stakeholders and contractors
Financing and Sustainability Challenges for COP Initiatives

COP initiative teams, similar to leaders of many ambitious social policy initiatives, have struggled with financing and sustaining valuable programs and services over time. Too often, grant and other funding supporting multi-sector, place-based initiatives are heavily focused on expensive deep-end intervention services as opposed to prevention services. When funding is available to support innovations in prevention and support, it is frequently time-limited. And the economic downturn of the past several years has made once-stable and reliable public funding streams vulnerable to cuts and elimination as taxpayers reassess public investments in social programs and services.

Understandably, COP leaders see great promise in incentive-based and social innovation financing strategies. However, questions remain. What do they entail? How and under what circumstances are they used successfully to fund comprehensive family and children's services initiatives? And what are the most salient political, financial and logistical issues to be considered?
COP grantees share important characteristics that position them to successfully implement incentive-based financing strategies. All participating organizations, agencies and community groups have:

- a shared social agenda
- shared outcome measurement
- mutually reinforcing programs and activities
- continuous communication
- backbone support through an intermediary

These critical features are key readiness factors for implementing incentive-based financing strategies. As the COP initiatives have matured, their leaders have learned from their successes and failures about the importance of sound financing for sustainability. As documented in The Finance Project’s case studies of Palm Beach County, Fla., and Alameda County, Calif., adapting to changing conditions and thinking creatively about financing have been important success factors for many grantees. These same qualities will continue to be important as they continue their work after their COP grants are terminated.

Public-Private Partnerships

Public-private partnerships provide the opportunity to realize economic efficiencies while aligning public and private funding to better serve children and families in their communities. All COP grantees have successfully employed public-private partnerships to some extent to sustain interventions and services over time.

Table I: Public-Private Partnerships: Key Elements for Success

<table>
<thead>
<tr>
<th>Element</th>
<th>COP Initiatives</th>
<th>Examples</th>
<th>Potential Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
<td>Some</td>
</tr>
<tr>
<td>Common Goals</td>
<td></td>
<td></td>
<td>All COP grantees have developed and nurtured effective partnerships. It is one of the underlying premises of the grant program.</td>
</tr>
<tr>
<td>Committed Resources</td>
<td></td>
<td></td>
<td>Through partnerships and partner agencies, organizations have the opportunity to tap resources from a wide array of sources, some of which individual agencies and organizations would not be eligible to use.</td>
</tr>
<tr>
<td>Shared Responsibilities</td>
<td></td>
<td></td>
<td>Partner organizations generally have different internal strengths and resources that can enhance the performance and effectiveness of the partnership as a whole.</td>
</tr>
</tbody>
</table>
**Benefits**

Public-private partnerships have the potential to sustain organizations and insulate services in the face of fiscal challenges. When public funding is threatened by economic conditions or local or state political transitions, resources from private partners can provide critical bridge funding. Additionally, private partners often have access to different types of internal resources (i.e., strategic communications staff, relationships with national experts) that can be leveraged to expand services provided by the partnership and build community support for the Children’s Outcome Projects.

**Chances for Success**

- **High:** Public-private partnerships have proven successful in several COP sites as well as in related initiatives such as Promise Neighborhoods sites.
- **Best Bets:** Partnerships with private health care organizations, private social services agencies and private colleges and universities that have technical skills and other resources that can be leveraged to support key functional needs in COP sites such as training and technical assistance, access to data, and communications and outreach.

**Performance-Based Contracts**

COP initiatives with a strong intermediary or “backbone” organization are well-positioned to implement performance-based contracting initiatives. Several COP sites have had success implementing PBCs.

### Table 2: Performance-Based Contracts: Key Elements For Success

<table>
<thead>
<tr>
<th>Element</th>
<th>COP Initiatives</th>
<th>Examples</th>
<th>Potential Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
<td>Some</td>
</tr>
<tr>
<td>A successful intervention</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clear benchmarks for success</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tying payments to specific outcome measures or milestones</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strong political and community support</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capacity of providers</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Benefits

Performance-based contracts are primarily used to improve performance among existing contracted service providers and as a mechanism to hold low performers accountable. The benefits that result are typically better outcomes for the same or lower cost to the agency that is the contract administrator. Unlike other incentive-based financing strategies discussed in this brief, PBCs are not designed to increase the amount of working capital available to fund comprehensive services. In fact, one important question to determine is how any savings that does result will be used — to reward strong contractor performance, to reduce the taxpayer burden or to expand prevention programs. If savings can be captured and reinvested in more preventive services, then it may be possible to expand community services, but that should not be a primary goal of PBCs.

Chances for Success

- **High:** Performance-based contracts can be used to fund an array of social services where there are a significant number of contracted service providers and where it is possible to determine clear benchmarks for success. Key to the success of PBCs is a fundamental agreement between the funding agency and contractors on the outcomes they are striving to achieve, the benchmarks for measuring progress, the data that will be used for measurement and the terms for payment.

- **Best Bets:** Programs for which there are clear performance objectives and clear measures of success, such as job employment programs and interventions supporting maternal prenatal health and wellness (attaining a job, increasing health of babies/decreasing low-birth weight babies) are most amenable to PBC financing.
Pay For Success/Social Impact Bonds

The PFS and SIB models are new and innovative. They have generated significant interest, but there are limited examples that shed light on the pros and cons of using these financing strategies to fund multi-sector, place-based initiatives. To the extent that COP grantees have identified proven, evidence-based interventions that result in measurable improvements in their communities, PFS/SIB may be a potential financing strategy. But they need to have sufficient financial capacity to invest up front in building the necessary program and service structure to effectively support high-risk families with young children. They also need to define outcomes that align with investors’ timetables for determining success and measuring return on investment. That probably is not 20 to 30 years. Finally, they need well developed data systems that can support return on investment analysis. The Utah High-Quality Preschool PFS bond, supported by investments by Goldman Sachs and the JB Pritzker Family Foundation, will be an important model for COP leaders to follow. Emerging feasibility studies in South Carolina and the District of Columbia and emerging PFS models in Minnesota, Colorado and other states also will provide important models and lessons learned for COP leaders interested in designing PFS financing strategies.

Table 3: Pay-For-Success: Key Elements For Success

<table>
<thead>
<tr>
<th>Element</th>
<th>COP Initiatives</th>
<th>Examples</th>
<th>Potential Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>A successful intervention</td>
<td>Yes</td>
<td>Several COP sites are implementing evidence-based interventions.</td>
<td></td>
</tr>
<tr>
<td>Philanthropic and private investors to provide start-up capital</td>
<td>No</td>
<td>Some COP sites may need to cultivate relationships with national and/or regional investors with significant wealth and/or endowments.</td>
<td></td>
</tr>
<tr>
<td>Nonprofit community-based organizations to deliver services</td>
<td>Some</td>
<td>Some COP sites have invested heavily in building the capacity of community-based organizations.</td>
<td>Community-based organizations must be trusted partners, able to deliver high-quality results on time and within budget.</td>
</tr>
<tr>
<td>Impartial program evaluator</td>
<td>Yes</td>
<td></td>
<td>While some COP sites have well-developed evaluation capacities and systems, PFS will require initiatives to contract with impartial, highly competent evaluators.</td>
</tr>
<tr>
<td>Intermediary to manage contracts</td>
<td>No</td>
<td></td>
<td>Intermediaries should be trusted organizations with adequate program and fiscal staff to manage complex contracts and payouts with public and private organizations and agencies.</td>
</tr>
</tbody>
</table>

Benefits

As noted above, PFS provides critical infusions of cash to fund proven prevention strategies that benefit vulnerable target populations in communities and can prevent the need for more costly interventions such as incarceration, remediation and deep-end services. PFS investments provide a unique financing structure that allows implementers of new proven strategies to scale up and serve a larger target population without increased direct government support.
There are no current examples of PFS supporting early childhood, child welfare or education programs, however, a number of emerging initiatives are underway. Among the most significant barriers is the lengthy time frame for measuring the success of these initiatives. However, COP grantees interested in pursuing PFS as a financing strategy have emerging models to observe and a growing cadre of financing experts to turn to for advice and information.

**Chances for Success**

- **Emerging:** PFS may be adaptable to funding early childhood and child welfare initiatives such as Nurse-Family Partnerships that produce well-documented results where the net societal benefits far outweigh the costs. In September 2013, the Colorado Governor’s Office of Policy and Research posted a request for information inviting responses from potential partners for a state Pay-for-Success strategy. The Mayor’s Office of Budget and Finance in District of Columbia is planning a study to explore the feasibility of the implementation of PFS in the nation’s capital. Finally, Goldman Sachs, the Pritzker Foundation and United Way have teamed up for a PFS pilot to scale up the United Way of Salt Lake City, Utah’s High-Quality Preschool Program. Key to their success will be:
  - defining outcomes that meet investors’ time tables for determining success and measuring return on investment
  - structuring financing to build up front the necessary community capacity to effectively achieve desired outcomes for vulnerable young children and their families
  - maintaining high-quality data systems with the capacity to produce sound return on investment analysis

- **Best Bets:** Implementing a PFS strategy is feasible when there is a program model or intervention that is highly likely to produce positive outcomes and that those outcomes produce net savings to the government. Additionally, the strategy must be serving only a small portion of the population in need of or eligible for the service/strategy. Finally, and perhaps most critically, the financing model must provide reasonable time frames for a mix of commercial and philanthropic investors to realize a return on their investments.

If COP leaders and stakeholders pursue innovative incentive-based investment strategies to sustain their initiatives going forward, particularly those that are still largely unproven, they will need to take several steps to foster success. The Finance Project, as well as other researchers and groups, have clearly identified these necessary steps. They include:

- **Embracing incentive-based investing primarily as a vehicle for achieving social outcomes rather than financial benefits.** Financial returns to investors are likely to vary in timing and magnitude across communities and social problems. The risk of principal loss is unlikely to be offset by the potential return, at least in the short term. Consequently, investors should be motivated more by the potential social benefit than by the potential financial results.

- **Paying careful attention to design and implementation.** Today’s experimental efforts are very likely to become models for future development. Therefore, effective collaboration among partners, sound project and financial management systems, rigorous data collection and evaluation, and operational creativity and flexibility are critical. To successfully scale up incentive-based investment will require increased standardization of design, implementation and cost-benefit methodologies, based on the experience and lessons learned from early efforts.
• Gathering information and documenting lessons learned from implementation, effective and essential design elements, and best practices. To advance the field, program designers and implementers need to work closely with researchers to gather relevant implementation and impact data and document their experiences. Building a solid base of knowledge of the effects and effectiveness of incentive-based investment will require investments in pilot financing projects in many communities and across several social problems. It will also require sound measurement to provide reliable evidence of social outcomes as well as to track the costs and allocation of resources and the payments to investors. Designers, implementers and researchers need to share their findings widely. They also need to share practical tools and resources that are in development and hold great promise for smoothing the pathway toward future success with incentive-based investment strategies.

• Undertaking a sound communications effort to clarify what incentive-based investing is, how incentive-based investing works, and what stakeholders can expect to gain or lose. Incentive-based investment is largely new and in some respects complicated, so it requires a well-coordinated education effort to ensure stakeholders and potential investors are well informed. This will require concerted and coordinated messages and outreach to policymakers, program designers, academic researchers and the media to help stakeholders become comfortable with the new financing models, appreciate the potential risks and benefits, and understand how to responsibly move forward with incentive-based investment in their own communities.