



From Potential to Action:

BRINGING SOCIAL
IMPACT BONDS
TO THE US

McKinsey & Company is a global management consulting firm. Our Social Sector Office helps the world's leading institutions develop and deliver solutions to chronic, complex societal challenges in the areas of global health, economic development, education, and climate change. Our mission is to bring an objective, fact-based approach to all of our work in order to strengthen our clients' ability to deliver meaningful and sustainable change.

CONTENTS

04	Preface
07	Executive summary
11	Chapter 1: Introduction
22	Chapter 2: Assessing the potential of SIBs in homelessness and criminal justice
35	Chapter 3: An assessment of the SIB ecosystem
46	Chapter 4: A pro forma analysis of a juvenile justice SIB
54	Chapter 5: Conclusion
	Appendices
58	Acknowledgements
61	Homelessness technical appendix
66	Criminal justice technical appendix

Preface

Assessing a nascent market—or one that isn't clearly defined—is a tricky undertaking. This is precisely the challenge we confronted when we sought to scan the market for social impact bonds (SIBs) in the United States.

Simply stated, a SIB is a new approach for expanding social programs. It is a partnership in which philanthropic funders and impact investors—not governments—take on the financial risk of scaling up. Nonprofits deliver the program; the government pays only if the program succeeds. Because the concept of SIBs is so new (the first and only SIB is being piloted in the United Kingdom), information about how—and how well—they could work is currently very limited.

This report represents our initial contribution to the discussion. We conducted a rigorous, data-driven analysis of the potential and capacity for SIBs in the United States. We disaggregated the SIB ecosystem into stakeholder groups (constituents, government, nonprofit service providers, investors, intermediaries, evaluation advisers, and independent assessors), identified the obstacles each group might face, and thought through how those obstacles would affect the ecosystem as a whole. We studied how SIBs might be applied in two program areas (homelessness and criminal justice), and did a pro forma analysis of a SIB in the juvenile justice arena to show how the economics of a SIB could play out. Throughout our research, we avoided the temptation to gaze into our crystal ball: for example, rather than project how current trends (such as changing demographics) might affect the longer-term potential of SIBs, we stuck to the facts—basing all our analysis on the most recently available data from government agencies, nonpartisan research institutions, foundations, and academia.

Although our findings will be of interest to a diverse audience, including think tanks, financial advisers, academics, and the media, our work is primarily geared toward three particular groups: policy makers and government administrators looking to create cross-sector partnerships to scale evidence-based social solutions, investors able to prioritize social impact over financial returns, and nonprofit service providers seeking multiyear growth capital to expand preventive social programs.

MOVING SOCIAL INNOVATION FORWARD

Through our Social Sector office, McKinsey is committed to fostering social innovation. We find SIBs an interesting concept because we believe social innovation happens at the intersection of the public, private, and social sectors. Indeed, SIBs bring these three sectors together: under a SIB contract, government works with private investors and nonprofit service providers to scale up high-impact programs that help people in need. Our research on SIBs represents a natural progression of our work on social innovation. In our view, two of the most important elements of social innovation are social finance and social impact assessment—and SIBs are strongly rooted in both.

Social finance mobilizes additional capital—or increases the effectiveness of current funding—to maximize impact. It unlocks value in the social sector by overcoming barriers that hinder the growth of social initiatives—barriers such as poor cash-flow management, fragmented demand, and demand uncertainty. Our work in the field of social finance encompasses the areas of global public health (for example, advanced market commitments) and financial inclusion. SIBs are another example of how incentives and investment can be recalibrated to stimulate social change.

Social impact assessment is a complex topic. In April 2010, we launched our “Learning for Social Impact” initiative (lsi.mckinsey.com), which provides a database of 150 tools and assessment methods, a collection of best practices, a workbook, and other practical resources to encourage an attitude of learning consistent with the development and scaling of evidence-based programs. Exploring SIBs, which include assessment as a key structural component, is a logical next phase of this work.

In addition to this report on SIBs, we are developing two sets of tools that can be used by stakeholders who choose to pursue SIBs. A number of partners are contributing to the design and testing of these tools including the Nonprofit Finance Fund (NFF); we will make these tools available to stakeholders through NFF’s Pay for Success Learning Hub (payforsuccess.org).

Rapid suitability assessment. Many stakeholders have expressed a need for a way to ascertain whether their organizations—as well as potential partner organizations—are well suited to SIBs. We are designing a set of easy-to-use Web-based questionnaires, each of which takes only 10 minutes to complete, to help stakeholders identify their (or their potential partners’) strengths and areas for development relevant to SIBs.

Capabilities due diligence. Each SIB stakeholder brings to the table different skills and abilities. A thorough capabilities due diligence will give investors and other stakeholders an understanding of their partners’ ability to fulfill their roles. We will provide a capabilities checklist tailored to each stakeholder, along with an interview guide, a document request list, data-gathering templates, a scoring rubric, and a how-to guide for conducting a streamlined due-diligence process.

ACKNOWLEDGEMENTS

In keeping with the multistakeholder spirit of SIBs, we engaged a range of thought partners when we launched this effort in mid-2011. Our advisory group was made up of a diverse set of stakeholders in the SIB ecosystem: nonprofit service providers, intermediaries, investors, advisers, evaluators, and academics. We are grateful to the following 16 individuals—the members of our advisory group—for their time, probing questions, and thoughtful commentary:

Amit Bouri, Global Impact Investing Network
Cathy Clark, Center for the Advancement of Social Entrepreneurship, Duke University
Joel Copperman, Center for Alternative Sentencing and Employment Services
Kristin Giantris, Nonprofit Finance Fund
Steve Goldberg, Social Finance US
Megan Golden, Robert F. Wagner Graduate School of Public Service, New York University
John Goldstein, Imprint Capital
Rosanne Haggerty, Community Solutions
Lisa Hall, Calvert Foundation
David Hunter, Hunter Consulting
Jitinder Kohli, Center for American Progress
Patrick Lawler, Youth Villages
Natasha Lifton
JoAnne Page, Fortune Society
Tracy Palandjian, Social Finance US
Drew von Glahn, Third Sector Capital Partners

We would also like to thank Nancy Barrant of The Robert Wood Johnson Foundation; Stephanie Cohn and Amy Klement of Omidyar Network; Jacob Harold of The William and Flora Hewlett Foundation; Kippy Joseph and Justina Lai of The Rockefeller Foundation; and Clara Miller of The F. B. Heron Foundation for their help.

More than 100 other thought leaders informed our study and analysis. Their names and affiliations are listed in the appendix.

Finally, we would like to acknowledge our colleagues Albert Bollard, Rebekah Emanuel, Rushabh Kapashi, Zach Marks, Genisha Saverimuthu, John Willey, and Thorsten Wirkes who made valuable contributions to this report.

We are committed to making this US market scan a living resource. As such, we structured our analysis in a way that can be expanded to keep pace with SIB market growth. We have shared our methodology with Social Finance US, an organization that has provided extensive support in the preparation of this project. Social Finance US will periodically update the analysis and make the results available to all interested parties.

Our research and expert interviews have led us to the conclusion that SIBs have potential as a tool to help solve America's societal problems at scale. We see this report as just a beginning—a starting point to capture the current state of affairs and inform stakeholders who choose to take action on SIBs.

Laura Callanan
Jonathan Law
Lenny Mendonca

May 2012

Executive summary

A social impact bond (SIB) is a new approach for scaling social programs. Currently being piloted in the United Kingdom and generating interest globally, a SIB is a multistakeholder partnership in which philanthropic funders and impact investors—not governments—take on the financial risk of expanding preventive programs that help poor and vulnerable people. Nonprofits deliver the program to more people who need it; the government pays only if the program succeeds. Because the concept of a SIB is so new (the first and only SIB is the UK pilot mentioned above), information about how—and how well—this approach could work is very limited. In this report, the most thoroughly researched study of SIBs to date, we explain how SIBs are structured, assess their potential in two specific program areas (homelessness and criminal justice), describe the various stakeholder groups involved, and present the results of a pro forma analysis of a hypothetical SIB.

SIB BASICS

A SIB structures a government contract for social services as a type of pay-for-performance contract. There are seven stakeholder groups involved in a SIB: constituents (the direct beneficiaries of the social services), government, nonprofit service providers, investors, intermediaries (responsible for overall SIB project management), evaluation advisers (to help monitor and refine the program), and independent assessors (to determine if SIB targets are met).

SIB investors provide capital that fulfills two purposes: up front, it pays for the services of the nonprofit service provider and, over the lifetime of the SIB, for the intermediary, the evaluation adviser, and the independent assessor. The intermediary raises capital from investors, selects the service providers, contracts with government, works with the evaluation adviser and the independent assessor to set and measure performance targets, and partners with the evaluation adviser to monitor and analyze interim results and suggest midcourse corrections. If the program meets performance targets, the government pays the intermediary an agreed amount. The intermediary is responsible for repaying the investors their capital plus a return on investment.

The primary benefits of SIBs

The participation of the intermediary, the evaluation adviser, and the independent assessor adds cost when compared with a scenario in which the government pays a service provider directly. So are SIBs worth the trouble? Our research suggests they are, under the right conditions. SIBs offer three major benefits:

SIBs are a tool to scale proven social interventions. SIBs could fill a critical void: other than market-based approaches, a structured and replicable model for scaling proven solutions has not existed previously. SIBs can give structure to the critical handoff between philanthropy (the risk capital of social innovation) and government (the scale-up capital of social innovation) to bring evidence-based interventions to more people. SIBs can do this by aligning incentives among a broad set of stakeholders and shifting financial risk away from government.

SIBs support government's goal of performance transformation. SIBs can help government move toward paying for results rather than paying for activities. The oversight and support provided to a SIB-funded program are intended to boost quality and performance, making successful implementation more likely. SIBs can also facilitate another critical shift, moving resources from remediation to prevention: they focus on forward-thinking programs that anticipate and ameliorate

problems before they arise rather than after they've materialized and negatively affected individuals and communities. If SIBs work as intended, they could enhance alignment and collaboration across government agencies. They could also reinforce and accelerate government's adoption of robust, coordinated data systems, which are key to understanding whether new programs have made a difference.

SIBs reward the social sector's investment in what works. To date, some nonprofit service providers have faced a frustrating situation: they've taken the time to collect data and discover what works for vulnerable people, only to find that there is no way to get these alternative programs to scale. SIBs can help break this pattern, rewarding service providers who have created effective programs.

SIBS IN HOMELESSNESS AND CRIMINAL JUSTICE

To develop a more precise understanding of SIBs' potential in the United States, we conducted in-depth analyses of two social issues—homelessness and criminal justice—that experts repeatedly told us could benefit tremendously from SIBs. We structured our analyses around four key questions:

- Are the current remedial costs on a scale that makes the potential savings meaningful?
- Are there proven preventive interventions to help the target population?
- Are there service providers with the capacity to scale these interventions?
- Is there a meaningful number of constituents who could be served?

Our findings indicate that homelessness—with as much as \$6 billion to \$7 billion in government spending on remedial programs, at least one proven preventive intervention (Permanent Supportive Housing) that benefits chronically homeless people, a large number of qualified service providers, and approximately 110,000 chronically homeless constituents—would be a natural focus area for SIBs. Another potential program area is juvenile and adult criminal justice. Government spending on national corrections is significant—\$74 billion in 2007—although SIBs can address only a fraction of current spending since not all prisoners will be eligible for preventive programs. We identified four proven interventions for youth and two for adults, and although there aren't enough providers focused exclusively on correctional alternatives, there are many at-scale providers of preventive programs in areas like youth services, substance abuse treatment, and mental health treatment. As for the constituent population, a subset of the more than 50,000 incarcerated youth who are nonviolent offenders and the 1.6 million incarcerated adults with mental health or substance abuse disorders could receive treatment in community-based programs. Even in just the two areas we studied, there's a vast difference in the availability of data and, consequently, in the nature of the conclusions we can draw. These differences underscore the importance of undertaking a detailed analysis for SIBs in each new program area.

THE SIB ECOSYSTEM

Each stakeholder group involved in a SIB must have certain characteristics and capabilities, and will face different challenges:

Service providers. SIBs offer a way for nonprofit service providers to scale proven interventions. To be ready to scale through a SIB, service providers need a strong operating model, a thorough understanding of what it will take to adapt and expand the target intervention, familiarity with social impact assessment, and experience working with partners. Local community knowledge and relationships will also be important. Service providers that have already qualified for government contracts may be likely candidates for early SIBs.

Government. SIBs are already generating interest from federal, state, and city governments. Local governments that decide to pursue SIBs may consider specific actions including spearheading pilots, coordinating among programs and agencies on SIB terms and structure, and ensuring that their data systems are capable of tracking cost and service utilization at the client level. If the federal government chooses to continue the support it has already shown pay-for-success approaches, it could play a critical role in incentivizing cross-agency collaboration and providing supplemental financial support for program assessment.

Investors. First-wave SIBs will most likely attract philanthropic funders and “Impact First” impact investors willing to accept below-market financial returns. “Finance First” impact investors may be interested in future SIBs, especially if their returns can be enhanced. Investors will understandably be hesitant to fund an untested model. Intermediaries structuring SIBs could raise investors’ comfort level by standardizing SIBs through consistent structures and common templates, promoting SIBs that scale proven (rather than promising) interventions, and constructing SIBs in such a way that repayment is tied to the achievement of social outcomes as opposed to government savings.

Intermediaries. Because they manage a SIB throughout its entire life cycle, intermediaries must possess expertise in the relevant social issue, financing skills, and project management capabilities. Two kinds of organizations appear to have the capabilities to play the SIB intermediary role: established organizations with broad skills and mandates and newly formed organizations like Social Finance US, which is specifically focused on SIBs. A robust cadre of SIB intermediaries will be needed for SIBs to reach critical mass; we believe community development financial institutions, community development venture capital funds, and community foundations will ultimately fill this role.

Evaluators. Every SIB requires two evaluators, each fulfilling a distinct role: one is an ongoing adviser to the intermediary and the service provider, while the other is an arm’s-length auditor that assesses whether the SIB met its performance targets. We have coined the terms “evaluation adviser” and “independent assessor” to describe these roles. Qualified organizations will likely have similar skill sets: program area expertise, extensive evaluation experience, and a collaborative attitude. We found eight evaluation firms interested in and capable of playing either role.

Our research and expert interviews indicate that within the SIB ecosystem are competent players who could launch the first wave of SIBs. We therefore do not expect stakeholder capacity to be a constraint.

A PRO FORMA ANALYSIS OF A JUVENILE JUSTICE SIB

To help stakeholders understand how a SIB might be structured, we constructed an analysis of a hypothetical SIB. We sought answers to questions such as: what’s the potential for taxpayer

benefits? How long will it take to pay back investors? Our analysis is not representative of SIB economics in general, but our analytical approach, the assumptions we made, and how we applied intervention data can inform the field's understanding of how SIBs can be structured.

We chose Functional Family Therapy (FFT) as the preventive intervention for our pro forma analysis, relying heavily on data from the Washington State Institute for Public Policy (WSIPP). We imagined a SIB that delivered FFT to a total of 4,500 youths over 3 years (one cohort of 1,500 15-year-old youths per year). Factoring in the additional costs inherent in a SIB, the SIB needs 12 years to generate a reasonable level of taxpayer benefits, government savings, and investor returns. In contrast, FFT breaks even in only 8 years if the government simply went directly to FFT service providers and paid them to expand the program to more constituents.

This highlights a crucial point: SIBs are an expensive way to finance the scaling up of preventive programs. A SIB's "premium" is justified if conventional options aren't working, or if the SIB helps government, philanthropy, and other social sector actors align their priorities and play their roles more effectively and efficiently.

THE WAY FORWARD

If stakeholders choose to pursue SIBs, three actions can help ensure success: developing a robust education and communications plan, embracing SIBs primarily for their social (rather than financial) benefits, and paying careful attention to design and implementation for early SIBs, which will be much-studied role models for future SIBs. To justify broad scale-up, SIBs must demonstrate a number of proof points: for instance, they must prove successful in multiple jurisdictions and program areas, and show clear evidence of social outcomes.

As we look to a future in which SIBs are but one part of a broader conversation about public-private collaboration and innovation to serve people and communities better, we reiterate two important points:

SIB scaling will require standardization. While they will always be relatively bespoke, SIBs will benefit from standardization as soon as—and wherever—possible. Stakeholders can advance SIBs by sharing best practice methods for cost benefit analysis and for scoping new program areas and geographies; by making diagnostic tools, term sheets, and report formats publicly available; and by communicating lessons learned about what it takes to make a SIB partnership successful.

Much remains to be seen. A number of issues are beyond the scope of our research, and a number of questions on the future of SIBs remain open. For example, will SIBs become a permanent part of the government financing landscape? Based on experience demonstrated through a SIB, will government choose to fund additional preventive programs by contracting directly with service providers? Will government begin to issue traditional municipal bonds to provide financing?

We see SIBs as part of a broader effort to transform the social sector to better serve the needs of people and their communities. Whether or not SIBs become a popular approach to scaling interventions, they have already generated excitement and enthusiasm for finding new ways to address persistent social problems. If SIBs galvanize a new wave of innovation and pave the way for other alternative models, their impact will be truly significant.

1. Introduction

You are the CEO of a nonprofit organization focused on a critical social issue—say, homelessness. Your organization has developed a program that has helped 100 people in your city move into stable living situations and get their lives back on track. Over time, you have tested and refined your approach and assessed the results. You can demonstrate that your program prevents chronic homelessness, and you'd like to expand it to help more people in your state—but you don't have the funding to do so. The foundations that have supported the development and testing of your program don't have sufficient resources to help you take it to scale.

Or perhaps you are a government administrator. You are frustrated at the lack of progress the government has made in eradicating homelessness. You realize that some government programs are tackling the problem too late—they are mostly remedial in nature and aren't making a sustainable impact; the statistics refuse to budge. You think it's time to try new programs, especially preventive solutions, and you have both the reach and the resources to make a meaningful difference. Current ways of working make it difficult to replace existing programs with alternatives—but, given the opportunity, that's just what you'd like to do.

These scenarios are playing out every day, on almost every social issue. Nonprofits with successful preventive programs struggle to scale them; government continues to spend money on some ineffective remedial programs; society loses out. What's to be done?

Enter the social impact bond (SIB)—a new tool for scaling programs that help poor and vulnerable people. Currently being piloted in the United Kingdom but generating interest globally, a SIB is a multistakeholder partnership in which philanthropic funders and impact investors—not governments—take on the financial risk of expanding proven social programs. Nonprofits deliver the social program to more people who need it; the government pays only if the program succeeds.

Because SIBs are so new—the UK pilot is currently the world's one and only SIB—much of what's been written about them has been based on theory rather than data. In this report, the most thoroughly researched study of SIBs to date, we discuss the benefits and limitations of SIBs and explore their potential in the United States. In addition to reviewing the relevant literature, we conducted more than 125 interviews with subject-matter experts and created a quantitative model showing how a SIB might work. Our objectives were to evaluate SIBs' benefits and costs, identify the constraints to SIBs in the United States, identify options to overcome these constraints, help stakeholders assess whether SIBs are right for them, and provide the information they would need to begin planning for a SIB.

In this first chapter, we explain what a SIB is, describe how it works and who it benefits, and discuss the current state of play in the United States and elsewhere.

WHAT IS A SOCIAL IMPACT BOND?

Despite its name, a SIB is not a bond at all (see box, “Mind the misnomer: A social impact bond is not a bond”). Rather, it is an innovative form of cross-sector collaboration that can help government transition from funding remedial efforts to addressing social problems through higher-impact, less costly preventive solutions.

Philanthropic donors fund pilots that demonstrate the efficacy of preventive programs, but that’s as far as it goes. Programs that work aren’t always expanded to the entire population that needs them because only government has the reach and the resources to provide the multiyear funding required for scale-up. But government’s existing legacy systems tend to focus on remediation, and fiscal constraints can make it tough to introduce alternative approaches.

SIBs offer a new option for expanding proven preventive programs. They can facilitate the critical handoff from philanthropy—which provides the “risk capital” of social innovation by funding and testing new programs—to government, which has both the capital and policy influence to take programs to scale. While all the potential applications have not been fully explored, SIBs seem especially well suited to scale interventions focused on behavior change.¹ Their initial focus on programs requiring intense case management, and the integrated role of assessment to ensure quality replication, suggest SIBs are highly applicable to multifaceted behavior change interventions. Other methods for scaling, which tend to be more market oriented, lend themselves best to expanding access to products (bed nets, for instance) and services (such as access to clean water).

A SIB is a new approach for expanding successful social programs. It is a partnership in which private investors —not governments—provide capital for nonprofits to scale up. The government pays only if the program succeeds.

¹ Behavior change programs share information and provide motivation to assist individuals in changing their behavior for positive social benefits. Examples range from drunk driving campaigns to sobriety programs to programs for low-income first-time mothers (such as the Nurse-Family Partnership).

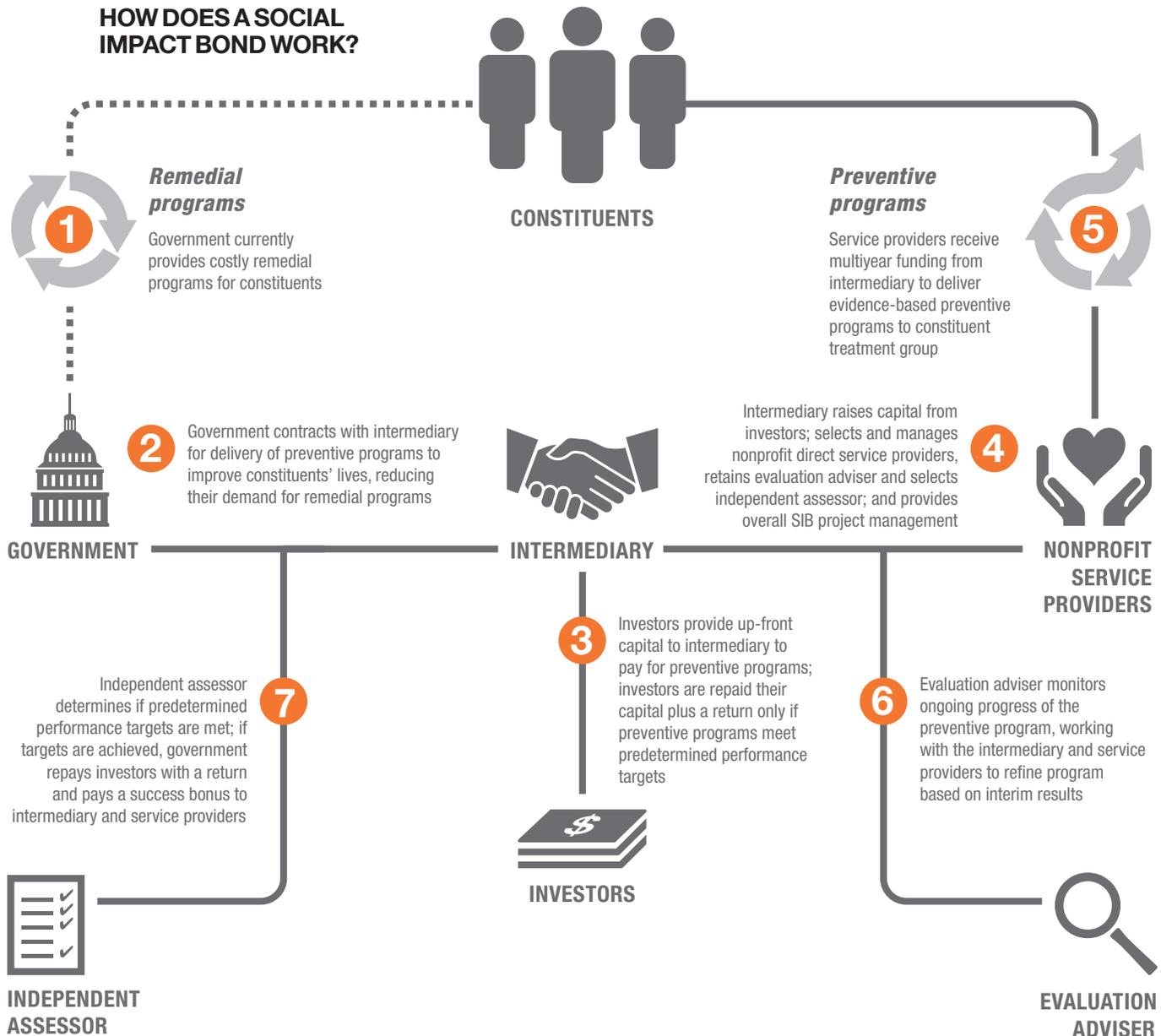
Mind the misnomer: A social impact bond is not a bond

A bond is a debt investment in which an investor loans money to a bond issuer for a defined time period at an agreed interest rate. Cities and states typically issue municipal bonds and similar debt instruments to fund capital projects and manage ongoing financing needs. These municipal bonds are backed either by specific revenue streams (bonds issued to build a toll road, for example, are repaid with toll revenue) or by the issuing government's general obligation and full taxing authority.

SIBs are not bonds or debt instruments but rather multistakeholder partnerships managed through a series of contracts. (In fact, the original notion was to call them “social impact partnerships,” not bonds.) SIBs bear some resemblance to the multiyear contracts governments already enter into, which are subject to annual budget appropriations. Without special legislative authority, the government's obligation to pay SIB investors will not be commensurate with its obligation to pay traditional municipal bondholders.

The state of Minnesota recently introduced Human Capital Performance Bonds—now commonly referred to as “Minnesota Bonds” or “HUCAPs”—that in some ways resemble traditional municipal bonds and in other ways resemble SIBs. Minnesota Bonds are sold to private investors and backed by annual appropriations from the state budget. Their proceeds are used to pay direct service providers once these providers hit predefined performance targets.

HOW DOES A SOCIAL IMPACT BOND WORK?



Glossary of terms

Remedial services: Government programs that address negative social outcomes after they've occurred (e.g., incarceration for criminals, emergency room access for the chronically homeless).

Preventive interventions: Social service programs that focus on avoiding negative social outcomes (e.g., alternatives to incarceration, permanent supportive housing for the chronically homeless).

Constituent treatment group: Those individuals who benefit from the preventive intervention and whose results are compared to others who did not receive similar services.

- 1 **Constituents** are the heart of a SIB's work. They are the people who will directly benefit from the social interventions funded and scaled through a SIB. They might include chronically homeless or incarcerated individuals.

State and local **governments** *already provide (or contract with nonprofit service providers that provide)* remedial services to these constituents, paid for out of taxpayer funds.
- 2 Knowing that there are preventive solutions that have been proven to improve constituents' lives and reduce the need for remedial services, the state or local government *enters a contract* with an **intermediary** to develop a SIB. (Note that without government support, SIBs will not happen.) Under the contract, the intermediary takes responsibility for identifying qualified nonprofit service providers and evidence-based preventive solutions, raising capital from investors to bring the solutions to scale, conducting ongoing project management, and working with the nonprofit service providers to ensure effective implementation. The government agrees to repay investors—via the intermediary—capital plus a return on investment if the program meets predetermined performance targets (for example, a percent reduction in recidivism). If the performance targets are met, the intermediary and the service provider will also receive a success fee. The intermediary links all the other stakeholders together in the service of the constituents.
- 3 In the near term, due to the high level of risk, SIB **investors** likely will be private foundations or others who prioritize benefits to society over financial rewards for themselves. (We expect that, over time, impact investors will become more interested in SIBs.) The SIB investors *transfer funds through the intermediary* to pay the nonprofit service provider to deliver services, cover a management fee for the intermediary, and pay the costs of evaluation. SIB investors understand that they will be repaid only if the preventive program achieves preset performance targets.
- 4 The intermediary *provides multiyear funding* to one or more **nonprofit service providers** to scale up preventive solutions. As noted above, these service providers stand to receive a bonus if they deliver the promised outcomes.
- 5 The nonprofit service providers scale up their operations and deliver *preventive interventions* to an expanded group of constituents.
- 6 As the nonprofit service providers deliver the program under the multiyear SIB contract, the intermediary *monitors performance and ensures that the program continues to deliver as expected* as it reaches scale. To do this, the intermediary hires an **evaluation adviser**. The evaluation adviser is involved in a number of activities, including determining the evaluation approach, defining performance outcomes, monitoring progress, and suggesting course corrections if needed.
- 7 An **independent assessor** is also involved in setting the evaluation approach and defining performance outcomes. When it comes time to determine whether the performance targets in the SIB contract have been met, the independent assessor reviews the constituent treatment group relative to a counterfactual, and *reports on whether the target outcomes have been achieved*. Based on the assessor's report, the government knows whether, and how much, to repay investors according to the terms of the SIB.

Government provides services for individuals and communities in areas such as shelter, health care, and foster care. It sometimes delivers these services directly, but more often, it contracts with nonprofit organizations to operate homeless shelters, community health clinics, and foster homes. A SIB structures a government contract for social services as a type of pay-for-performance contract, with the financial risk shifted to investors.

SIB investors provide capital that fulfills two purposes: up front, it pays for the services of the nonprofit service provider and, over the lifetime of the SIB, for the intermediary, the evaluation adviser, and the independent assessor.

The SIB intermediary coordinates this multifaceted partnership. The intermediary raises capital from investors, selects the service providers, contracts with government, works with the independent assessor and the evaluation adviser to set and measure performance targets, and partners with the evaluation adviser to monitor and analyze interim results and suggest midcourse corrections.

If specific social outcomes are achieved (see box, “Measuring success: The ins and outs of inputs, activities, outputs, and outcomes”), the intervention is deemed successful and the government pays the intermediary an agreed amount. The intermediary is responsible for repaying the investors their capital plus a return on investment. The intermediary and the service provider also receive a performance payment if the intervention succeeds.

Although the participation of the intermediary, the evaluation adviser, and the independent assessor adds cost when compared with a scenario in which the government pays a service provider directly, the SIB structure is designed to add value as well. The oversight and support provided to a SIB-funded program is intended to boost quality and performance, making successful implementation more likely and helping programs to scale to new communities or geographies. SIB-funded programs are more expensive, suggesting SIBs should be used only if there are no suitable alternatives—but if SIBs deliver a more effective program, they will offer better value for money in the long run.

SIBs facilitate the critical handoff from from philanthropy to government.

Measuring success: The ins and outs of inputs, activities, outputs, and outcomes

When service providers plan an intervention—teaching prisoners a vocational skill such as barbering, for example—they aim to achieve a specific goal or set of goals. Perhaps they want to increase inmates' future employability, make them more confident, and keep them occupied so they avoid violent behavior while in jail. These changes that result from an intervention are the **outcomes**.

Achieving an outcome requires **inputs**. In the barbering example, inputs would include trainers who know the barbering craft, equipment (razors, scissors, combs, and so on), and heads on which to practice. After a set of **activities**—such as hair-cutting lessons and technique demonstrations—it becomes possible to measure the **output** of the activities. In this case, one output is the number of inmates who acquire barbering skills.

Today many social programs are judged based on inputs, activities, or outputs. These types of metrics, however, are not the optimal way to assess whether the program is achieving its goals. A barbering certificate, after all, may not automatically result in postincarceration employment. Take the case of Marc La Cloche, a former New York State inmate who was denied the license required to practice the craft he spent hours honing in prison.*

Because things don't always go as planned, the emphasis should be on measuring outcomes: were the inmates able to secure and retain barbering jobs when they were released from prison? Outcomes are the most accurate measures of whether a social program is on the right track or whether it needs redirection.

Measuring social impact is not a straightforward science. For more on our recommended approach, please see lsi.mckinsey.com.

* Clyde Haberman, "Ex-inmate's legacy: Victory over bias and catch-22 bureaucracy," *New York Times*, August 29, 2008.

What makes SIBs appealing to stakeholders

SIBs are generating interest for several reasons. One reason is that public-private partnerships and other multistakeholder arrangements have been shown to be effective ways to address complex, dynamic problems that exceed the capacity of a single sector or actor. SIBs, if executed well, can spur cross-sector collaboration and cooperation.

Another reason is that the government is already familiar with the concept of paying for results—but has yet to apply it to social issues.² With SIBs, all the financial risk involved in scaling up a social program rests with the investors who will be paid only if performance targets are achieved; government thus pays for results rather than paying for activities. SIBs can give government a risk-free way to transition from existing remedial efforts to higher-impact, less costly preventive solutions.

² Governments at the city, state, and federal level use pay-for-performance contracts for construction projects, environmental cleanup, and other activities. In some cases, the contract includes a fixed payment coupled with a bonus for meeting specified performance targets. In other cases, contractors bear the financial risk: they must secure up-front working capital from investors or other sources to fulfill the contract, and they recoup their costs only if they meet performance targets.

Funding what works—driving more dollars to high-performing nonprofits and their programs—seems obvious but has not always been the reality in the social sector. The recent recession has focused funders and service providers on the need to do more with less and on the benefits of putting resources behind programs that have demonstrated success. The 2011 publication of *Leap of Reason*³ reignited the discussion of “managing to outcomes” and “results-based management.” SIBs build off this philosophy and reward those who have invested in developing programs and proving that they work.

SIBs are also attracting interest because the community of “impact investors”—private foundations, family offices, individuals, and others who use their investment capital not just to reap financial returns but to benefit society—is growing. Over the past 10 years, more investors have begun to let their values guide their financial investments, seeking ways to do well while doing good.

Total benefits to society

Much of the discourse on SIBs emphasizes the financial savings that government may realize by replacing more expensive remedial programs with less expensive preventive interventions. However, multiple funding streams, limited data systems, and lack of cross-agency coordination may inhibit government’s ability to fully recognize the financial savings from a SIB. While some stakeholders describe this as more an accounting problem than a savings problem, in our view, SIBs are primarily a vehicle for scaling up a preventive program that delivers significant social impact rather than a reliable source of cost savings.

In this report, we evaluate SIBs not on their savings potential for government budgets but on their broader benefits to society. We follow the lead of the Washington State Institute for Public Policy (WSIPP), which considers three groups—constituents, taxpayers, and what we will call “avoiders”—when evaluating the costs and benefits of government-funded social programs.

Constituents—the direct recipients of the social services—experience tangible benefits (such as increased earnings) as well as intangible benefits (such as greater confidence in reintegrating into society).

Taxpayers benefit because SIBs reduce the need for expensive services and infrastructure that taxpayers finance. For example, if offenders are served through community-based alternatives to incarceration, fewer prison beds are needed. When ex-offenders successfully reenter society, get jobs, and pay taxes, tax revenues increase.

Avoiders—or what WSIPP refers to as “nonparticipants in other nontaxpayer roles”—are individuals who benefit precisely because something does not happen that otherwise would have. People who would have been crime victims, for instance, will avoid the trauma of being victimized, the loss of property, or physical injury.⁴

3 Mario Morino, *Leap of Reason: Managing to Outcomes in an Era of Scarcity*, Washington, DC: Venture Philanthropy Partners, 2011.

4 Steve Aos et al, “Return on investment: Evidence-based options to improve statewide outcomes,” *Technical Appendix II Methods and User Manual*, Washington State Institute for Public Policy, July 2011, p. 7.

Design choices for SIBs: The parameters we set for our research

Stakeholders are debating and discussing different constructs for SIBs, and using inconsistent terminology to do so. For example, while the Obama Administration sticks to the term “pay for success” (PFS), other government actors use the terms SIB and PFS interchangeably; still others refer to SIBs as a type of PFS contract. Because of the range of perspectives, we realized we needed to create parameters for our research. We made the following assumptions as we studied how SIBs could work:

The SIB’s impact is measured in total benefits to society—not just in immediate cash savings for the government. SIBs may result in measurable savings to government in the near term, but capturing the savings requires government agency coordination that may be difficult to orchestrate. Because there’s no guarantee such coordination will actually happen, we chose to focus on all the benefits—financial and social—that SIBs generate within a reasonable period of time (10 to 12 years).

The SIB is for scaling proven—not promising—interventions. Simply because they are so new, SIBs carry risks—both in their structural model and in their execution—that cannot be entirely mitigated in the near term. Interventions carry risks as well. A SIB that focuses on proven interventions carries primarily execution risk related to the intervention, whereas a SIB that seeks to scale up promising but unproven interventions carries both execution risk and model risk related to the intervention, and is much less likely to attract investment. While innovation and experimentation are undeniably valuable, we confined our research to SIBs that help scale up programs that have been shown to work.

The government enlists an intermediary to manage the SIB. Managing a SIB’s multiple stakeholders is a full-time job. For the purposes of our research, we assumed that the entity that provides the social services would be free to focus exclusively on its core competency—service provision—without also having to interact constantly with the government, investors, and other stakeholders. This third-party moderator would connect stakeholders, coordinate all the moving pieces, and replace underperforming service providers.

Nonprofit organizations provide the services. Some government functions—road construction, for instance—can be effectively outsourced to the private sector. Whatever the long-term prospects for private provision might be, we expect that nonprofit organizations will remain the leading providers of preventive interventions for homeless citizens or criminal offenders. Results for social programs are difficult to measure, and the work must be driven by the social bottom line, not just dollars and cents. Our research covers only SIBs in which nonprofits—not private-sector entities—provide the services.

HOW AND WHERE ARE SOCIAL IMPACT BONDS BEING USED TODAY?

The first SIB came into being in September 2010. After raising £5 million from philanthropic funders, Social Finance UK—a nongovernmental organization (NGO) that develops financing structures and raises capital to help fund social service organizations—launched a SIB to help rehabilitate 3,000 short-term prisoners at Peterborough Prison expected to be released over a six-year window.

Under the SIB contract, four UK nonprofits—St. Giles Trust, Ormiston Trust, the YMCA, and Supporting Others through Volunteer Action—are implementing programs to help inmates increase their education levels, vocational skills, and confidence both during and after confinement. The reoffending rate of the Peterborough prisoners will be measured against a control group of 30,000 short-term prisoners from other jails who are not receiving these preventive support services. If reoffending rates among the Peterborough prisoners drop by 7.5 percent, investors get a minimum payout of 7.5 percent; if reoffending rates are even lower the payout could increase up to 13.5 percent. However, if these outcomes are not achieved, the investors will lose their entire investment. (Interim results on reoffending rates and investment payments won't be available until 2014).

The SIB model is also being applied by the UK Department for Work and Pensions as part of a £30 million Innovation Fund, set up to attract private investment to tackle the problems faced by disadvantaged youth.⁵ Some local county councils in the United Kingdom are pursuing SIBs that total up to £40 million to scale programs for communities and families.⁶

Global interest

Although the United Kingdom is the only country currently hosting a SIB, other countries are taking notice. Social Innovation Europe, an initiative of the European Commission, has commissioned a report on SIBs. In Australia, the New South Wales government is in the development phase for three SIBs or, as they are being called in Australia, “social benefit bonds” in the areas of recidivism and out-of-home care for children.⁷

One NGO that focuses on Middle Eastern issues has established a task force to assess the potential of SIBs. The Portland Trust, an organization seeking to promote peace between Israel and Palestine, is determining whether SIBs could be successful in economic-development projects in the Middle East.

Canadian federal and provincial governments are also exploring whether SIBs are right for them. The 2012 federal budget mentions plans to test SIBs “to further encourage the development of government-community partnerships.”⁸ Ontario will “encourage improved outcomes at a lower cost by transforming traditional approaches to the delivery of services” through SIB pilots in a number of program areas over the next 18 months.⁹ The British Columbia Advisory Council on Social Entrepreneurship, established by the provincial parliament, has drafted a recommendation to pilot SIBs as a way to foster public-sector innovation.¹⁰

SIBs in the United States

In the last year, US local and state governments have been exploring SIBs and a broader array of PFS models. Early interest in SIBs has focused on two social issues: chronic homelessness and criminal and juvenile justice. SIB uptake will likely occur in places where those two issues are among a governor's or a mayor's current priorities.

5 David Ainsworth, “Two new social impact bond-style investments launched,” *Third Sector Online*, January 24, 2012.

6 Kaye Wiggins, “Office for Civil Society to trial £40m social impact bond scheme to support ‘problem families’,” *Third Sector Online*, August 26, 2011.

7 “NSW government announces joint development phase for social benefit bonds,” March 20, 2012 (treasury.nsw.gov.au).

8 “Supporting families and communities,” chapter 3.4, *Jobs growth and long-term prosperity: Economic action plan 2012*, Government of Canada, March 29, 2012 (budget.gc.ca).

9 “Transforming public services,” chapter 1, *Strong action for Ontario: 2012 Ontario budget*, Ontario Ministry of Finance, 2012 (fin.gov.on.ca).

10 See socialinnovationbc.ca.

A SIB is a new approach for expanding successful social programs. It is a partnership in which private investors — not governments—provide capital for nonprofits to scale up. The government pays only if the program succeeds.

Massachusetts is a case in point. At the top of Governor Deval Patrick's agenda is the problem of homelessness: he has made a \$38.5 million commitment to overhaul the emergency-assistance program and move homeless people into apartments or congregate care. Massachusetts is focusing one of its first SIB pilots on homelessness. Pursuant to a June 2011 request for information, in January 2012 the state government sought two submissions from service providers and two from intermediaries in the areas of chronic homelessness and juvenile justice. For the former, the goal is twofold: to provide stable housing for several hundred chronically homeless people and reduce housing and Medicaid costs. In the juvenile justice pilot, the administration wants to reduce recidivism and improve education and employment outcomes for a significant number of the 750 youths who leave probation systems and juvenile correction facilities each year.¹¹

Elsewhere in the country, a number of cities and states—including New York City and the states of Connecticut, New York, and Michigan—are actively exploring SIBs. That said, most jurisdictions that have indicated an interest in SIBs are still a long way from launching one.

At the federal level, there has been some activity as well. In October 2011 the White House Office of Social Innovation and Civic Participation convened a forum called “Pay for Success: Investing in What Works,” at which SIBs were discussed. President Obama has signaled his support of PFS pilots by seeking congressional authority to reserve up to \$100 million in his 2012 budget for a number of program areas including workforce development, education, juvenile justice, and care of children with disabilities. President Obama proposed extended availability for PFS funds to allow longer disbursement periods; he also requested permission to redirect PFS funds that are not used to make results-based payments. Congress rejected the president's proposal, but in the meantime the administration has launched PFS pilots that meet the current statutory guidelines. Over the course of 2012, the administration is running PFS pilots in criminal justice and workforce development through the Departments of Justice and Labor, respectively. President Obama's proposed 2013 budget includes up to \$109 million to test PFS in a broader range of program areas including education and homelessness.¹²

At this time, we are unable to project the aggregate dollar value of potential SIB deals nationally, nor can we reliably estimate the related taxpayer benefits. Doing so would require an accurate prediction as to the unique terms and economics of each potential deal. But to show how the economics of a SIB might work, we prepared a pro forma analysis of a SIB focused on juvenile justice. We devote Chapter 4 to that analysis.

11 “Massachusetts first state in the nation to pursue ‘Pay for Success’ social innovation contracts,” Executive Office for Administration and Finance, Commonwealth of Massachusetts, January 18, 2012 (mass.gov/anf).

12 *Fiscal year 2013 budget of the US government*, Office of Management and Budget, The White House, 2012, p. 45 (whitehouse.gov/omb).

2. Assessing the potential of SIBs to address homelessness and criminal justice

To develop a more precise understanding of how SIBs could work, we conducted in-depth analyses of two social issues—homelessness and criminal justice—that experts repeatedly told us could benefit tremendously from SIBs. Both issues matter to the public, and both are areas in which federal, state, and local government in the United States spends several billion dollars on remedial programs but much less on preventive programs. These are also areas in which behavior change interventions—a category of interventions with limited alternative approaches for scaling, and where SIBs can be an especially powerful tool—are most prominent.

Our intention in undertaking these analyses was to test the utility of SIBs and provide a fact base for stakeholders considering whether to use this new social innovation tool. Our goal was to assess whether SIBs could potentially work in these two program areas—not to recommend that SIBs necessarily be applied. We structured our analyses around four key questions that must be answered before the launch of any SIB—before partners are assembled and the important business of relationship building begins. We also identified specific challenges for SIBs in the areas of homelessness and juvenile and criminal justice.

- Are the current remedial costs on a scale that makes the economic savings generated by substituting a preventive solution meaningful?** SIBs can create taxpayer benefits by scaling proven preventive interventions that cost less than the remedial programs they replace. The difference in cost between the more expensive remedial program and the less expensive preventive program represents the upper limit of the taxpayer benefits SIBs can deliver. We note that preventive interventions scaled through SIBs will not entirely eliminate the need for all remedial programs. That said, to get a sense of the magnitude of a SIB's potential, we estimated the current costs of existing remedial programs. Because structuring and managing a SIB takes time and effort, some threshold of taxpayer benefits needs to be met to justify using a SIB. That threshold will vary by case but is an important consideration when deciding whether to use a SIB.
- Are there proven preventive interventions to help the target population?** We studied the range of preventive interventions and looked for objective evidence of efficacy.¹³
- Are there service providers who can scale these interventions?** Without competent service providers to deliver the preventive interventions, the entire SIB structure is for naught. We looked for healthy and stable nonprofit service providers with strong core operations, familiarity with the relevant intervention, and the capacity to scale.
- Is there a meaningful number of constituents who could be served?** A SIB's structure involves several actors, each charging a fee or expecting a return. As a result, it is a more complicated and expensive way to scale programs than if government simply contracted directly with a service provider. To justify using a SIB—and to make the economics of the SIB structure work due to the additional costs involved—the SIB must benefit a meaningful

13 312 effective programs received at least one of the following ratings from the seven registries in the United States: from the Coalition for Evidence-Based Policy's Social Programs That Work—Top Tier, Near Top Tier, Promising; from Blueprints for Violence Prevention at the Center for the Study and Prevention of Violence, Institute of Behavioral Science—Model Program, Promising Program; from Promising Practices Network—Proven, Promising; from Child Trends' Lifecourse Interventions to Nurture Kids Successfully—Effective; from Communities That Care—Effective; from the Office of Justice Programs' CrimeSolutions.gov—Effective, Promising; and from the Office of Juvenile Justice and Delinquency Prevention's Model Programs Guide—Exemplary, Effective, Promising.

number of constituents. What that number ought to be will vary by case. To arrive at estimates of the size of the constituent population in homelessness and criminal justice, we studied the relevant government data, academic research, and other publicly available sources.

In this chapter, we discuss the answers to these four questions, first for chronic homelessness then for juvenile and criminal justice. (We tackle the questions in a different order for each program area, beginning with those on which we found the most reliable data.) We also lay out the challenges stakeholders can expect to encounter as they seek to scale preventive interventions in each of these areas. This analysis is not intended to recommend whether SIBs are the right tool to address challenges in homelessness, juvenile and criminal justice, or any other area of social welfare. Rather, the goal was to test SIBs' potential, should stakeholders decide to pursue them.

COMBATING CHRONIC HOMELESSNESS

On any given night, more than 600,000 people in the United States are homeless.¹⁴ While homeless people face different struggles, most share an inability to secure affordable housing. A subset of the total homeless population is “chronically homeless,” which the federal government defines as “an unaccompanied homeless individual with a disabling condition, or a family with at least one adult member who has a disabling condition who has either been continually homeless for a year or more OR has had at least four episodes of homelessness in the past three years.”¹⁵ While chronically homeless people account for a minority of the total homeless population—there were approximately 110,000 chronically homeless persons in the United States in 2010—they require significant services from federal, state, and local systems. As mentioned in the previous chapter, chronic homelessness is one of the two issues that the Commonwealth of Massachusetts has chosen to address through social innovation financing.

Doing the math:

Estimating government spending on remedial homeless programs

To understand current funding streams for homeless programs, we reviewed federal reports and agency Web sites and conducted expert interviews. We looked at federal, state, and local government spending on emergency and transitional shelters. Whenever possible we excluded spending on preventive programs such as Permanent Supportive Housing (PSH) interventions or rental voucher programs. We did not examine spending from other sources such as foundations or individuals.

Programs serving the homeless population at the federal level fall into two categories: targeted programs and mainstream programs.

Targeted programs cater specifically to homeless individuals or families. We relied on the US Interagency Council on Homelessness (USICH) for federal spending estimates on homeless programs, and then used state and local matching ratios to calculate total government spending

14 *The 2010 annual homeless assessment report to Congress*, US Department of Housing and Urban Development, 2010 (hudhre.info/documents/2010HomelessAssessmentReport.pdf).

15 “Notice of funding availability for the Continuum of Care Homeless Assistance Program,” US Department of Housing and Urban Development, 2010, p. 7 (hud.gov).

nationally. Total spend on targeted remedial programs through the Department of Housing and Urban Development (HUD), the Department of Health and Human Services (HHS), the Department of Veterans Affairs (VA), and other government entities was approximately \$3.1 billion in 2010.¹⁶

Mainstream programs serve homeless people as well as a broader population. A number of mainstream programs—Medicaid, Temporary Assistance to Needy Families (TANF), Supplemental Security Income (SSI), Supplemental Nutrition Assistance Program (Food Stamps), and Child Welfare—are the most important to the homeless population and were the focus of our research. We calculated Medicaid spending using both top-down (USICH data and state and local matching ratios) and bottom-up approaches (segmenting homeless people into subpopulations and estimating per-person Medicaid expenditures for each subpopulation). We used only bottom-up approaches to calculate spending on TANF, SSI, Food Stamps, and Child Welfare. Our estimate of total government spending on homelessness through mainstream programs: between \$2.5 billion and \$3.6 billion in 2010.

Our estimate of combined federal, state, and local government spending on both targeted and mainstream remedial programs for homeless people was between \$6 billion and \$7 billion in 2010. For more detailed information behind these numbers, please consult the technical appendix on homelessness.

Evidence-based interventions: Permanent Supportive Housing

Among the various approaches to addressing the needs of homeless people—approaches including family reunification, subsidy, and behavioral and mental health interventions—PSH is one that is backed by a considerable body of research and evidence demonstrating its effectiveness. While we recognize that PSH is not the only solution to homelessness, we selected it as an example of a program that meets the eligibility requirements for scaling through a SIB (see seven SIB eligibility requirements below).

PSH programs help homeless individuals live as independently as possible by giving them long-term subsidized housing as well as supportive services including core case management, primary and mental health care, substance abuse treatment, and educational and vocational training. Although PSH is primarily intended to benefit people who are chronically homeless, mentally ill and “episodic” homeless people can also take advantage of it.

More than 20 studies have documented the efficacy of PSH, which is credited with reducing government spending, boosting housing-retention rates, and lowering substance abuse rates and recidivism.¹⁷ The four most frequently cited studies are as follows:

- **New York City:** A landmark study examined 4,679 severely mentally ill homeless people placed in a PSH program. **Result:** significant declines in use of both shelters (86 percent in the treatment group versus 6 percent in the control group) and public hospitals (78 percent decline in the treatment group versus 53 percent in the control group).¹⁸

16 Appendix to *Opening Doors: Federal strategic plan to prevent and end homelessness: Update 2011*, US Interagency Council on Homelessness.

17 Studies include analyses on interventions in Chicago, Cleveland, Denver, New Orleans, New York City, Philadelphia, San Diego, San Francisco, Seattle, and Washington DC; and in Connecticut, Maine, Massachusetts, Minnesota, Oregon, and Rhode Island.

18 “Public service reductions associated with placement of homeless persons with severe mental illness in supportive housing,” Dennis P. Culhane, *Housing Policy Debate*, Vol. 13, No. 1, 2002, pp. 107–63.

- **Chicago:** The AIDS Foundation of Chicago, a consortium of 15 service providers, led a PSH intervention. **Result:** 29 percent fewer hospitalizations and 24 percent fewer ER visits than the control group.¹⁹
- **Seattle:** The Downtown Emergency Service Center led a PSH intervention focused on chronically homeless people with severe alcohol problems. **Result:** taxpayer savings of \$4 million in the first year of operation with a target population of 95 people.²⁰
- **Massachusetts:** The Massachusetts Housing and Shelter Alliance implemented a statewide “Home & Healthy for Good” program. **Result:** an 82 percent residential stability rate among participants and state government savings of approximately \$9,600 per tenant.²¹

We defined seven basic SIB eligibility requirements and tested how PSH stacks up against them.

A SIB-funded intervention must...	PSH fits the bill because...
Focus on prevention	It is a preventive solution
Have a multi year track record (at least five years)	It has been in existence for more than 20 years
Have a demonstrated record of rigorous evaluations	Multiple studies have shown efficacy of PSH through randomized control trials or quasi-experimental designs (e.g., Chicago, New York, Seattle)
Deliver statistically significant results	Multiple studies have shown that PSH yields benefits such as higher housing stability rates
Meet the needs of a sizable population	There were more than 110,000 chronically homeless persons in the United States in 2010
Be replicable and scalable	PSH has been successfully implemented in multiple states
Deliver taxpayer benefits in less than five years	Some PSH programs help government realize cost savings in their first year of operation

19 “Effect of a housing and case management program on emergency department visits and hospitalizations among chronically ill homeless adults,” Laura S. Sadowski et al, *Journal of the American Medical Association*, Vol. 301, No. 17, 2009, pp. 1771–8.

20 “Health care and public service use and costs before and after provision of housing for chronically homeless persons with severe alcohol problems,” Mary E. Larimer et al, *Journal of the American Medical Association*, Vol. 301, No. 13, 2009, pp. 1349–57.

21 *Home & Healthy for Good: A statewide pilot housing first program: Progress report*, Massachusetts Housing and Shelter Alliance, June 2011.

We use PSH here to illustrate how SIBs can help scale a proven solution to a persistent social problem—not to promote PSH as the single most effective intervention for addressing chronic homelessness. In fact, experts on homelessness point out that the availability of housing units will not necessarily end homelessness. In the words of Muzzy Rosenblatt, executive director of Bowery Residents’ Committee, “Homelessness is as much, if not more, an issue of behavior and health, poor choices and education, and simple but extreme poverty.” Options other than PSH may be a better solution for some homeless individuals, and may even cost less than PSH. However, PSH is an example of an approach that has been studied extensively and meets the other SIB criteria we described earlier.

Qualified service providers are available

The delivery of the preventive intervention is crucial to a SIB’s success. If the intervention is not implemented competently and well, the entire SIB structure will be for naught. Service providers need to be healthy and stable organizations with strong core operations, a familiarity with the relevant intervention, the capacity to scale, and the willingness to be part of the great SIB experiment.

Service provider capacity does not appear to be a problem for scaling up PSH, as there are many competent PSH providers. In 2010 HUD provided Continuum of Care grants to 3,200 PSH providers, of which 200 received more than \$1 million in funding—suggesting that these organizations are big enough to be able to scale up PSH programs.²²

A meaningful number of constituents

In 2010, of the 197,600 people who were either currently or formerly chronically homeless, only 44 percent (87,600 individuals) were benefiting from preventive interventions such as PSH.²³ The remaining 56 percent (110,000 people) were on the streets or in emergency housing.²⁴ Helping all chronically homeless people, therefore, would require a doubling of the capacity of preventive interventions. Together, the states of New York, Louisiana, Texas, Florida, and California account for 55 percent of the chronically homeless population; efforts to scale up prevention programs might therefore be concentrated in those states.

Challenges in scaling PSH through SIBs

Successful scaling requires delivery of a proven intervention with fidelity. At the same time, adaptation and innovation are crucial to ensuring that the intervention is relevant and effective when applied to new populations and changing circumstances. (For a concrete example of changing circumstances, see “How will changes in Medicaid affect PSH?” on p.27) The focus of delivering with fidelity will vary for every intervention: in some cases, the “secret sauce” is the core content, while in others it is the experience or process of delivery that matters most. Codification of a program’s key components, rigorous staff training, ongoing monitoring, and quality control will help service providers stay true to the fundamental principles of the intervention as they scale it.

22 FY 2010 Continuum of Care Grants Awards for all states and District of Columbia, US Department of Housing and Urban Development (hud.gov).

23 Based on estimate that ~37 percent of 236,798 Permanent Supportive Housing beds are used by chronically homeless, *The 2010 annual homeless assessment report to Congress*, US Department of Housing and Urban Development, 2010, p. 41 (www.hudhre.info/documents/2010HomelessAssessmentReport.pdf).

24 *The 2010 annual homeless assessment report to Congress*, US Department of Housing and Urban Development, 2010, p. 8 (www.hudhre.info/documents/2010HomelessAssessmentReport.pdf).

How will changes in Medicaid affect PSH?

Chronically homeless people are among the highest-cost users of health services. Medicaid accounts for a significant portion of mainstream program spending for homeless people. Today, when a chronically homeless person is in a PSH program, managed care organizations can more easily enroll him or her in a Medicaid plan. An increase in managed care enrollment can save state governments money: the fixed monthly fee of managed care plans replaces the high costs of uncompensated health care.

In 2014, the Affordable Care Act (ACA) will extend Medicaid eligibility to all chronically homeless people, whether or not they are in PSH programs. While this change may yield many social benefits, it may disrupt

the current PSH ecosystem and have implications for SIBs. Under this new law, current health care providers for the homeless will have higher operating costs. Indeed, they will be required to get licensed to be eligible for Medicaid funding and will need to accommodate Medicaid enrollment and reimbursement procedures. More healthcare providers will also be eligible for Medicaid reimbursement for treating chronically homeless people. It's unclear exactly how the ACA will impact the PSH service-delivery model and any SIBs intended to scale PSH. Stakeholders should recognize that Medicaid and other payment streams may shift over time and explore ways to make SIBs work under changing conditions.

To effectively adjust a program, implementers need knowledge of the target constituents and community. This knowledge can provide guidance as to how to adapt an intervention to local nuances: service providers may need to adjust the order in which they present an intervention's modules, for instance, or the vocabulary or examples they use to convey content.

Service providers and other SIB stakeholders should keep in mind the following success factors for scaling PSH interventions with the support of a SIB:

Local knowledge. Providers should establish relationships with and links to local community stakeholders such as housing agencies, hospitals, care centers, property developers, and property managers. Local stakeholders understand their constituents' needs and the community's attitudes much more than outside groups that "parachute in." They know where services (public transportation and supermarkets, for example) are located, making them better able to identify ideal sites for PSH structures.

Multifaceted expertise. Because PSH is a holistic approach to solving chronic homelessness, service providers must have skill sets across a range of areas, including property management and case management.

Cross-agency collaboration. The government departments that fund PSH interventions are often not the same ones that receive the financial benefits when chronic homelessness drops. For instance, the funding for a program may come from HUD, but the savings that the program yields may benefit HHS (through a reduction in Medicaid expenditures). Cross-agency collaboration is important to the success of SIBs.

Local buy-in. Implementing a PHS intervention without involving the local community could result in a major backlash (“Not in my back yard”).

Availability of robust data. Measuring PSH outcomes will not be done through comparison with a control group and will, instead, most likely be based on pre- and postcost analyses of public-service utilization. Such analyses depend on the availability of robust administrative data collected by government. This may be a challenge to SIBs focused on PSH and must be addressed by stakeholders as the SIB structure is designed.

JUVENILE AND ADULT CRIMINAL JUSTICE

The first-ever SIB, currently being implemented in the United Kingdom, is focused on criminal justice. Its goal: reduce recidivism by treating substance abuse issues, securing housing, and improving the education, skills, and confidence of the incarcerated both during and after confinement.

We looked at the two systems that deal with correctional supervision and incarceration: the juvenile and adult criminal justice systems. The former seeks to rehabilitate offenders who are under the legal adult age (which varies by state); it attempts to help young offenders overcome the problems that led to their delinquent behavior and avoid further run-ins with the law. The latter oversees the arrest, imprisonment, probation, and parole of adult offenders. We investigated the barriers or enabling factors that could influence the implementation of SIBs in this program area in order to provide a fact base for stakeholders considering whether to use SIBs.

A meaningful number of constituents

At least one million prison inmates, including approximately 100,000 juveniles, could be candidates for alternatives to incarceration. Some individuals who are not in prison—at-risk youth, for example—could also qualify as constituents.

In 2007 (the most recent year for which data are available), almost 100,000 youth were incarcerated, more than half of whom were serving time for nonviolent offenses such as technical violations²⁵ or public order, property, and drug offenses. Not all the 100,000 youths can necessarily receive interventions in the community safely, but this group can be screened and appropriate candidates identified.

As for adult prisoners, more than 900,000 are in jail for drug-related offenses; approximately 1.6 million have a mental health or substance abuse disorder.²⁶ Among this latter group, less than half have received any professional treatment. More specifically:

- 11 percent have received treatment for substance abuse since admission²⁷
- 27 percent have received treatment for mental health issues since admission²⁸
- 35 percent of conditionally released offenders with substance abuse disorders received any form of addiction treatment²⁹

25 Office of Juvenile Justice and Delinquency Prevention, *Census of juveniles in residential placement, 1997–2010*; Bureau of Justice Statistics, *Sourcebook of Criminal Justice Statistics* (albany.edu/sourcebook). Includes status offenses.

26 The National Center on Addiction and Substance Abuse at Columbia University (NCASA), *Behind Bars II: Substance abuse and America's prison population*, February 2010, p. 26.

27 NCASA, *Behind Bars II*, p. 4.

28 Bureau of Justice Statistics, *Mental health problems of prison and jail inmates*, September 2006. Mental health problems are defined more broadly than mental health disorders, including history or symptoms meeting medical criteria.

29 NCASA, *Behind Bars II*, p. 58.

A subset of the 1.6 million inmates with mental health or substance abuse disorders may be candidates for community-based alternatives to incarceration.

These numbers reflect the uppermost limits on the constituent population, since community-based treatment programs will not be appropriate for all these individuals. Risk assessment models—such as the Violence Risk Appraisal Guide—can be used to determine who should remain incarcerated and who could receive treatment in a community-based program.³⁰

Evidence-based interventions: Youth and adult therapies

To identify the evidence-based interventions for juvenile and adult offenders that would make the most sense for SIBs, we studied all the registries of evidence-based programs focused on these fields.³¹ We identified six programs that meet the criteria for SIBs and are community-based preventive interventions. These programs offer an alternative to incarceration (ATI) and seek to monitor and rehabilitate court-involved individuals through programs and services delivered outside prisons and jails.

Youth therapies. There have been many rigorous evaluations of juvenile justice interventions. These evaluations have identified a number of therapeutic interventions that have yielded robust and sizeable effects on recidivism and other social outcomes. Three of the four interventions detailed below have demonstrated approximately a 50 percent effect on recidivism and have been widely adopted.

30 The Violence Risk Appraisal Guide, which predicts violent recidivism based on 12 measurable factors from an individual's personal, criminal, and substance abuse history, has been validated in multiple small-group studies.

31 The registries we studied included Coalition for Evidence-Based Policy; Blueprints for Violence Prevention at the Center for the Study and Prevention of Violence, Institute of Behavioral Science; Promising Practices Network; Child Trends' Lifecourse Interventions to Nurture Kids Successfully; Communities That Care; Office of Justice Programs' CrimeSolutions.gov; Office of Juvenile Justice and Delinquency Prevention's Model Programs Guide; and Washington State Institute for Public Policy. Additional registries of evidence-based programs we consulted that focus on other program areas include the Campbell Collaboration and the Cochrane Collaboration, which are health-oriented, internationally focused, and include meta-analysis of related programs. Currently, the Annie E. Casey Foundation is developing a registry of evidence-based programs related to its focus areas of youth and families.

Select youth interventions

Intervention	Description	Evidence that it works	Is it right for a SIB?
Multidimensional Treatment Foster Care (MTFC)	Rather than living in a group home with other youth offenders, youths are placed with specially trained foster families where they learn to accept rules and limits; build skills; and develop appropriate social behavior.	Two randomized controlled trials (RCTs) on girls showed a 40-50% decline in criminal referrals and pregnancies. One RCT on boys showed declines in criminal referrals. ³²	Maybe: Foster parents will need to receive special training, so the intervention may not be easily replicable and scalable.
Multisystemic Therapy (MST)	Parents learn to monitor and discipline their children so the family can stay together. Trained therapists are available 24/7.	Three studies demonstrate approximately 50% declines in criminal referrals. ³³	Maybe: It may not pay for itself through taxpayer benefits. It also incurs a hefty price tag because it mandates graduate-level therapists.
Functional Family Therapy (FFT)	This short-term (8-12 sessions) prevention or intervention treatment for troubled youths focuses on entire family functioning.	More than 10 studies found a 25-60% decline in criminal referrals. ³⁴	Yes: Its wide use suggests high potential to scale.
Brief Strategic Family Therapy (BSFT)	Developed for Hispanic families and now used among diverse ethnic populations, it targets kids aged 6-17 and their families in 12-16 weekly sessions.	Multiple studies show declines in measured conduct disorder, aggression, and drug use among participating youth. ³⁵	Maybe: It has been shown to work with the communities for which it was designed, but it may not meet the needs of a broader population and may not be easily replicable and scalable.

32 "Evidence summary for multidimensional treatment foster care (MTFC)," Coalition for Evidence-Based Policy (evidencebasedpolicy.org/docs/MultidimensionalTreatmentFosterCare.pdf).

33 Scott W. Henggeler, "Efficacy studies to large-scale transport: The development and validation of multisystemic therapy programs," *Annual Review of Clinical Psychology*, Vol. 7, April 2011, pp. 351-81.

34 James Alexander, Bruce Parsons, Christie Pugh et al, *Functional Family Therapy: Blueprints for Violence Prevention*, Book Three, Blueprints for Violence Prevention series, Delbert S. Elliott, ed., Boulder, CO: Center for the Study and Prevention of Violence, Institute of Behavioral Science, University of Colorado, 2000.

35 José Szapocznik and Robert A. Williams, "Brief strategic family therapy: Twenty-five years of interplay among theory, research and practice in adolescent behavior problems and drug abuse," *Clinical Child and Family Psychology Review*, Vol. 3, No. 2, June 2000, pp. 117-34.

Adult therapies. While there is real interest in moving—and keeping—juvenile offenders out of traditional correctional facilities, there has been less activity and rigor in evaluating alternatives to adult incarceration. Still, there are some promising findings. Substance abuse treatment programs like drug courts have demonstrated approximately a 25 percent effect on recidivism; certain mental health treatment programs have also yielded encouraging results. Behavioral therapies for teenagers have been successfully administered to young adults between the ages of 18 and 25. In our view, two interventions in particular warrant further evaluation: drug courts and Washington state’s Drug Offender Sentencing Alternative.

Because age is the greatest predictor of the risk that an inmate poses to society (the younger the inmate, the more likely he is to pose risk),³⁶ a long-term inmate who has reached age 55 or older in incarceration, for example, might be a good candidate for an ATI program. This requires some additional research by the criminal justice field to determine.

Select adult interventions

Intervention	Description	Evidence that it works	Is it right for a SIB?
Drug courts	To avoid incarceration, participants agree to attend a comprehensive court-monitored drug treatment program that may offer employment, mental health and family services.	A five-year examination of 23 drug courts in 8 states found that these courts significantly reduced drug use and criminal behavior of participants compared to similar offenders. ³⁷	Maybe: cooperation among multiple public agencies is critical.
Washington Drug Offender Sentencing Alternative (DOSA)	Prisoners receive reduced prison terms if—and only if—they complete a chemical-dependency treatment program.	There was an approximately 30% decline in 3-year recidivism rates among drug offenders. ³⁸	Maybe: new legislation would need to be enacted and judges would need to agree to refer inmates to the program.

36 *It's about time: Aging prisoners, increasing costs, and geriatric release*, Vera Institute of Justice, April 2010 (vera.org).

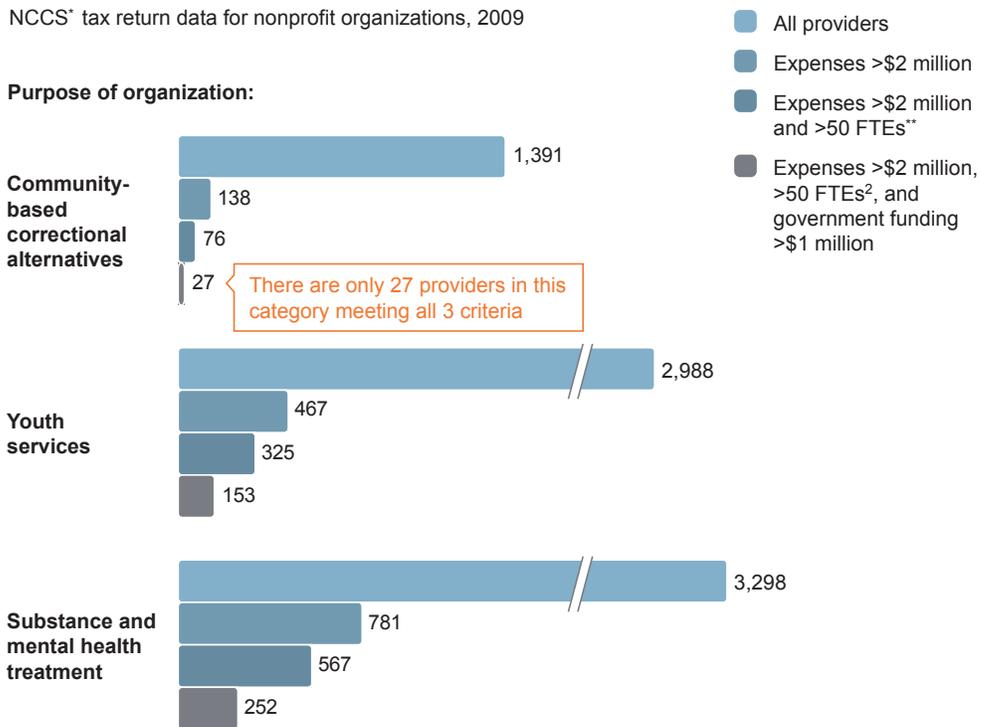
37 Christine H. Lindquist, Michael Rempel, John K. Roman, Shelli B. Rossman, and Janine M. Zweig, *The multi-site adult drug court evaluation*, Urban Institute Justice Policy Center, 2011.

38 *Washington's Drug Offender Sentencing Alternative: An evaluation of benefits and costs*, Washington State Institute for Public Policy, January 2005.

Qualified service providers are available

To find qualified service providers, we examined tax-return data from the Urban Institute’s National Center for Charitable Statistics. We looked for providers that met three criteria: the organization reported annual expenses of at least \$2 million, employs more than 50 full-time equivalents, and received more than \$1 million in estimated annual government funding. We identified 153 youth-services providers³⁹ and 252 providers focused on substance abuse and mental health treatment (Exhibit 2.1).⁴⁰

Exhibit 2.1: The number of juvenile and criminal justice service providers meeting scale criteria



* National Center for Charitable Statistics.
 ** Full-time equivalents.

39 There were 153 providers that met our scale criteria and whose National Taxonomy of Exempt Entities core classification was listed as “children and youth services” or “family counseling” (The Urban Institute National Center for Charitable Statistics, Core Files, P30 and P46, 2009).
 40 Providers that met our criteria and whose National Taxonomy of Exempt Entities core classification was listed as “substance abuse dependency, prevention and treatment,” “substance abuse treatment,” or “residential, mental health treatment” (The Urban Institute National Center for Charitable Statistics, Core Files, F20, F22, and F33, 2009).

Doing the math:

Estimating government spending on criminal justice

To estimate government spending on juvenile and adult criminal justice, we focused on the corrections components: all correctional and confinement institutions that hold prisoners for more than 48 hours, as well as probation activities, parole and pardon boards and programs, and halfway houses. And because not all prisoners will be eligible for preventive interventions, SIBs can address only a fraction of current spending. Experts believe that preventive programs account for only a small share of current corrections spending. However, the lack of national statistics makes it very difficult to reliably estimate the savings potential of SIBs focused on criminal justice interventions.

According to the most recent data available from the US Census Bureau, national corrections spending in 2007 was \$74 billion.⁴¹ Of that total, spending on youths accounted for approximately 10 percent (\$7 billion to \$8 billion), suggesting that average corrections spending per incarcerated youth and adult was approximately \$80,000 and \$30,000, respectively.⁴²

We are unable to estimate national remedial spending for specific subpopulations because the cost of incarceration for each individual varies, depending on three main factors. The first factor is the inmate's health: the sicker the inmate, the higher the cost of care. The second factor is length of stay: the quicker an inmate leaves the system, the less the government has to spend on him or her—although day one is typically the most expensive due to required medical checkups, transportation, and administrative processing. The third factor is required security level: inmates deemed dangerous must be placed in more expensive facilities with higher supervision levels.

Incarceration costs also vary significantly by state. The complexity, scale, and heterogeneity of the juvenile and adult criminal justice systems make it impossible to issue blanket statements or generalizations about SIBs in these areas. Instead, each SIB intervention must be evaluated on a case-by-case basis.

Challenges in scaling juvenile and criminal justice interventions with SIBs

As with a SIB addressing chronic homelessness, delivery of the intervention is crucial to SIB success in the criminal justice area. A SIB will work only if the nonprofit service providers are well equipped to do their job and can successfully implement the program. This will be challenging in light of the fact that many nonprofits are under-resourced, and much of their financing comes from donors that stress project funding at the expense of strong organizational infrastructure.

Securing critical buy-in. In any SIB, support from the government's executive branch or from specific agencies is important—but for scaling up ATI programs, it is insufficient. No SIB focused on criminal justice will succeed without the support of judges, who would need to direct a sufficient number of qualified participants into preventive programs in order for SIBs to achieve their constituent and economic targets within their preplanned time frames.

41 Bureau of Justice Statistics, Justice Expenditure and Employment Extracts, 2007.

42 See criminal justice technical appendix for our methodology for calculating youth-corrections expenditures.

Community-based alternatives for adult offenders can be politically unpopular with voters, and their implementation might depend on new legislation. Experts believe passing new legislation may not be as difficult as it seems, however; tightening government budgets may make such cost-saving proposals more palatable.

Even in just the two areas we studied, there's a vast difference in the availability of data and, consequently, in the nature of the conclusions we can draw. These differences underscore the importance of undertaking a detailed analysis for SIBs in each new program area before deciding whether this new approach should be implemented.

In summary, chronic homelessness—with as much as \$7 billion in remedial costs, approximately 110,000 constituents, and a proven intervention in PSH—appears to be an area that could benefit from SIBs. There are a large number of PSH providers capable of scaling up, including many who have already received contracts with the federal government. We agree with the Commonwealth of Massachusetts that homelessness is an issue where SIBs may be a suitable tool and deserve additional consideration.

In juvenile and adult criminal justice, a subset of the more than 50,000 incarcerated youth who are nonviolent offenders and the 1.6 million incarcerated adults with mental health or substance abuse disorders could receive treatment in community-based programs. Risk assessment models could be useful in identifying this subset. And there are proven interventions: we came across four for youth and two for adults. Although there aren't enough providers focused exclusively on correctional alternatives, there are many at-scale providers capable of delivering preventive programs in areas like youth services and substance and mental health treatment. Government spending on national corrections is significant—\$74 billion in 2007—although SIBs can address only a fraction of current spending since not all prisoners will be eligible for preventive programs. Still, the savings potential is meaningful. Again, this suggests SIBs may be an appropriate tool that deserves further evaluation.

3. An assessment of the SIB ecosystem

A SIB is a multistakeholder collaboration. In this chapter, we take a closer look at the stakeholder groups—namely governments, investors, intermediaries, and evaluators—that will play critical roles if SIBs are to be adopted in the United States. (Constituents are important stakeholders as well but play a less active role. The remaining stakeholder group, nonprofit service providers, is discussed in Chapter 2 as part of our deep dives into the program areas of homelessness and criminal justice.) We describe the characteristics and capabilities each group must have to make a SIB successful, the challenges each is likely to encounter, and the ways they might overcome these challenges if they decide to pursue SIBs. Where possible, we give a few examples of actors either already engaging in SIBs or possessing the requisite attributes.

We also studied the SIB ecosystem to determine whether capacity would be a constraint: are there enough players—or potential players—to make it possible for SIBs to become widespread in the United States? The answer seems to be yes.

GOVERNMENT: NO SUPPORT? NO SIB

Government can't scale new social solutions alone. If it were single-handedly capable, there would be no need for a multistakeholder approach like SIBs. Moving from remedial programs to preventive solutions requires a public-private partnership to shift the risk from government and allow a transformation to occur in the current system. Governments are exploring SIBs precisely because complex social problems demand a multistakeholder solution.

Government is the most critical stakeholder to SIB uptake—SIBs simply won't happen without government participation. Indeed, in light of shrinking budgets, SIBs and other PFS constructs are capturing the attention of government decision makers. Our interviews with officials from the federal Office of Management and Budget (OMB); the states of Connecticut, Massachusetts, Michigan, Minnesota, New York, Rhode Island, and Virginia; and the cities of Atlanta, Detroit, Louisville, Newark, and New York indicate that SIBs are generating energy and interest.

The catalyst for SIB progress is executive leadership. The first-mover cities and states all have a mayor or governor who champions the SIB concept. The Commonwealth of Massachusetts, for instance, with the full support of Governor Deval Patrick, is taking formal steps to establish a social innovation financing program focused on PFS contracts. "Social innovation financing is a tool that helps us tackle long-term social issues with innovative methods," Governor Patrick said in a press statement. "These initiatives will help us change the delivery of state services to save money and improve program performance."⁴³

Existing shared-savings programs in government already utilize performance-based contracting. Energy-service companies (ESCOs), for example, have been in the United States since the first oil crisis in the 1970s and are frequently utilized by the public sector. These private-sector enterprises address energy-management problems, improve building energy efficiency, reduce operating costs, and guarantee savings. When they enter into a shared-savings model, the ESCO and its client agree to share cost savings at a predetermined rate for a set number of years, but the ESCO takes on the performance and credit risk.⁴⁴ Lessons learned from ESCOs can help inform SIB uptake.

43 "Massachusetts first state in the nation to pursue 'Pay for Success' social innovation contracts," Executive Office for Administration and Finance, Commonwealth of Massachusetts, January 18, 2012 (mass.gov/anf).

44 World Energy Council, "The concept of ESCOs," chapter 3.6.1, *Energy efficiency policies around the world: Review and evaluation*, January 2008 (worldenergy.org).

Through interviews, research, and analysis we have identified some of the considerations that cities and states would have to address if they choose to pursue SIBs.

Bumps in the road—and potential solutions

The government officials we interviewed identified a set of challenges that could impede SIB adoption. But they also had some concrete suggestions as to how governments interested in pursuing SIBs could overcome these challenges.

Fear of the unknown. Because there are currently no SIBs in the United States—and relatively little information on SIBs anywhere—governments are understandably hesitant to jump in.

Overcoming the obstacle. Pilot efforts will go a long way toward clearing up questions and building momentum for SIBs. Pro forma analysis can also help illustrate how a SIB should work. Also, to minimize risks, the first SIBs should focus on proven interventions with a demonstrated evidence base. Only once the SIB approach becomes more familiar should promising programs—those that have merit but less evidence behind them—be considered.

Delayed impact. Elected officials are in office for only a few years, and voters cast their ballots based on what's happening now. The full benefits of SIBs won't typically accrue for five or more years, and some of the budgetary savings may arise from future cost avoidance—for example, a decline in recidivism making the construction of a planned new prison unnecessary—as opposed to immediate cost savings in the current year's budget. (See the pro forma analysis in Chapter 4, which illustrates a possible taxpayer-benefits path). **Overcoming the obstacle.** Focusing on the social impact and educating the public on the overall benefits to taxpayers won't shorten the time SIBs take but will help manage expectations. Government can benefit from the efforts of academics, intermediaries, and advisers who are shaping the SIB discussion. They can help clarify that this new approach can scale social impact and rebalance government spending toward outcome-based programs. They can also help set realistic expectations about whether SIBs will help save money and attract supplemental capital from private investors.

Business unusual. A SIB will likely touch multiple programs and agencies, and require coordination on terms and structure; agencies may resist giving up their power and autonomy. Another example: current contracting mechanisms may lack the flexibility SIBs will demand—such as allowing the SIB intermediary, not the government, to hire (and fire) the service providers. **Overcoming the obstacle.** At the discretion of the mayor or governor, a dedicated “super team” with central decision-making authority may be able to expedite the coordination needed across programs and agencies to make a SIB a reality. As for contracting, there will need to be some creativity: pilot programs of limited exemptions to regular rules, for example, can provide a solution.

The federal government can also choose to play a critical role in helping shift the status quo to facilitate the uptake of SIBs. Because a significant amount of funding for social services starts in Washington and then flows to states and cities, the federal government is well positioned to incentivize cross-agency collaboration, provide supplemental funding to defray assessment costs, and clear up misperceptions about SIBs. For example, OMB has clarified that state and local governments will not need any change in federal legislation to use federal dollars for SIB funding.⁴⁵

45 Interview with Gary Glickman, coordinator of the Partnership Fund for Program Integrity Innovation at the Office of Management and Budget, and Kathryn Stack, deputy associate director of education and human resources, Office of Management and Budget, January 19, 2012.

Difficulty in capturing benefits. Repaying investors from realized cash savings may require aggregating SIB benefits across multiple agencies and programs as well as different levels of government. This could prove challenging. In the case of homelessness, for instance, many groups—including HUD, HHS, the VA, and state and local agencies—share funding responsibility for the care of a chronically homeless person. **Overcoming the obstacle.** A first step may involve ensuring that government data systems are capable of tracking cost and service utilization at the client level. In addition, the super team described above could be very helpful here as well.

Stakeholders weigh in

We asked nonprofit service providers, intermediaries, philanthropic funders, evaluators, academics, and other advisers knowledgeable about innovative social finance and evidence-based programs how they thought government would view SIBs, and what the hurdles might be to cities and states embracing this approach.

When it comes to government’s goals for SIB participation, stakeholders’ opinions are divided. Some stakeholders predict government will participate in SIBs only if financial savings can be captured. Others believe government will embrace SIBs based on the social impact they can deliver, even if the financial savings cannot specifically be aggregated across agencies and realized. (The inability to capture savings when a less expensive preventive program replaces a more expensive remedial program has been characterized by Steve Goldberg at Social Finance US as an accounting problem rather than a savings problem.)

Our stakeholder interviews also surfaced concerns that government officials dismissed. For example, some thought there would be public backlash against SIBs as a “privatization” of government savings—that SIBs would be tantamount to giving government savings away to wealthy investors. Government officials we interviewed believe, however, that a well-managed communications process would help avoid this issue. Another stakeholder concern was that a need for new legislation would hinder SIB uptake. But the government officials we interviewed feel SIBs are similar enough to the multiyear contracts that government already enters into and won’t require full-faith and credit legislation to back payments. (Investor demand will, of course, determine if this will turn out to be the case.)

PARTNERSHIP PROFILE: THE STAKEHOLDERS IN A SIB

SIBs are partnerships. If SIBs happen, in order to function effectively, each of the seven stakeholder groups must do its part and work in collaboration with the others.

Constituents are the program beneficiaries. They are the people who need the social services. **What they'll do:** It depends. The constituents within the study group will receive the particular program or intervention. **What they won't do:** If they are part of the control group, they won't benefit from the intervention—but neither will they be hurt by it.*

Governments that choose to participate in SIBs are those looking to pay for results and drive more programming dollars to proven programs. **What they'll do:** If they decide SIBs are worth pursuing, enter into a contract with the intermediary and agree to performance targets designed by the independent assessor and evaluation adviser. **What they won't do:** Pay investors if performance targets aren't met.

Investors are the visionaries. They are foundations committed to innovative social finance, or impact investors eager to test a new funding approach. **What they'll do:** Fund—via the intermediary—nonprofit service providers to deliver preventive programs. **What they won't do:** Recoup their investment if the program fails to meet its targets. But they will get kudos for risk taking.

Nonprofit service providers are organizations capable of scaling up proven preventive interventions over a multiyear period. **What they'll do:** Contract with the intermediary so that they can get paid and get up and running, deliver services to constituents, and be open to evaluation from the independent assessor and evaluation adviser. **What they won't do:** Shy away from being held accountable for outcomes or from working as part of a multistakeholder partnership.

The intermediary is an organization that has content expertise, financing skills, and project-management capabilities. **What it will do:** Broker the deal among the government, the nonprofit service providers, and the investors; bring in the evaluation adviser and independent assessor; and manage all the moving parts throughout the SIB's lifespan. **What it won't do:** Settle for the status quo. The intermediary will always be on the lookout for ways to improve the program and deliver maximum results against performance targets.

The **evaluation adviser** will have specific content knowledge and experience with a range of assessment methods. **What it will do:** Play a hands-on role, helping the intermediary and service providers iterate and adapt the intervention and make midcourse corrections based on ongoing assessment. **What it won't do:** Remain detached and objective. The evaluation adviser is heavily invested in the project's success.

An **independent assessor** is an evaluator that also has specific content knowledge and experience with a range of assessment methods. **What it will do:** Help set performance targets that can be objectively assessed and then review them to determine if investors get paid. **What it won't do:** Participate in ongoing interpretation of performance results or advise service providers on how to adapt the program.

* The control group will not receive services, but it also won't be hurt by the SIB. In all likelihood, the control group will comprise individuals who were not receiving any preventive services to begin with. In addition, the SIB should strive as much as possible to avoid doing harm—even if the SIB fails.

INVESTORS: WHO WILL GET INVOLVED AND WHEN

The first SIBs in the United States are likely to attract two types of investors: philanthropic funders and so-called Impact First impact Investors.⁴⁶ Both types are investors interested in pioneering innovative approaches and motivated by the social impact SIBs could generate. They are willing to take a higher level of risk. For that reason, they don't necessarily represent the best test of what the market will bear in terms of government guarantees, rates of return, or even deal structure.

Philanthropic funders, including foundations and individual philanthropists, are already supporting SIB ecosystem development. These are funders committed to the social investing field and the development of evidence-based programs, or foundations committed to the social issues (including homelessness and criminal justice) that SIBs are likely to target. Foundations may want to support individual SIBs by defraying the costs of assessment, knowledge development, or technical assistance in the form of recoverable grants. (We note, however, that due to foundations' tightening budgets and recent cuts in evaluation dollars, SIBs will be competing with other program priorities for evaluation funding.) General ecosystem development and cost defrayment will probably be funded through traditional grants.

"Impact First" impact investors—foundations, family offices, qualified investors, and other institutions interested in maximizing social impact and willing to accept below-market financial returns—may also be interested in SIBs. The most likely participants will be foundations familiar with program-related investments (PRIs) and interested in SIB priority program areas. Early investors will have a high risk tolerance, and their return expectations will range from principal repayment to returns that keep pace with inflation. These investors are looking not for a risk-adjusted rate of return but for repayment tied to social impact instead of to taxpayer benefits. They are putting their money down because impact matters most to them; they understand that realizing taxpayer benefits will be complicated. But given the novelty of SIBs, foundation investors will likely make PRIs from their annual budgets, not their endowments.

As SIBs become more established, they may attract a third type of investor:

"Finance First" impact investors are foundations, family offices, qualified investors, and other institutions interested in market or near-market financial returns and a minimum level of social impact. Institutional and qualified investors are more likely to get involved than retail investors, though retail investors will be required to truly bring the SIBs to scale. Interest from Finance First investors will likely increase if SIB returns can be boosted by layering their investments on top of risk-absorbing, low-return-seeking philanthropic funding. Finance First investors are unlikely to get involved until multiple SIBs are on the market and the mechanism is well established. These investors could be right for a SIB fund of funds. Foundation investors that are Finance First are likely to invest from the mission-based investing allocation of their endowments.

Investors will understandably be hesitant to fund an untested model. SIBs' multistakeholder construct and the fact that repayment won't come from an earned revenue stream may make some

46 With support from the Rockefeller Foundation, Godeke Consulting is researching the SIB investor space and plans to share findings in 2012.

investors queasy. Also, the program areas for first-wave SIBs—homelessness and criminal and juvenile justice—are not the conventional focus areas for impact investing (which have historically funded programs related to microfinance, fair trade, and eco-friendly product development). One way to raise investors' comfort level would be to standardize SIBs through consistent structures and common templates, making it easier for investors to evaluate investment opportunities. Another way is to promote SIBs that scale proven (rather than promising) interventions. Finally, SIBs should be constructed in such a way that repayment is tied to the achievement of social outcomes as opposed to government savings. This is how the United Kingdom's Peterborough Prison SIB is set up.

There are efforts under way to develop dependable sources of funding for SIBs and similar blended-value opportunities. For example, Big Society Capital in the United Kingdom—a “social investment bank” set up to transform the flows of capital into the social sector—is funded with \$1 billion in equity, two-thirds of which comes from dormant bank accounts and one-third from banks. In the United States, leading funders are in discussions to form a “club” of investors committed to common impact-investing principles.

INTERMEDIARIES: EXPERTS IN PROGRAM MANAGEMENT

Intermediaries manage a SIB throughout its entire life cycle. They must possess expertise in the relevant social issue, financing skills, and project management capabilities. Their content knowledge must range from the strategic to the tactical: they must thoroughly understand the relevant program area, be familiar with social service delivery systems and impact assessment, and know the local actors. On the financing side, they must know how to conduct due diligence, raise capital from investors, and structure deals. (As SIB investors evolve from philanthropic to Impact First to Finance First, intermediaries' capital-raising skills will need to evolve, too.) Within project management, intermediaries will need portfolio management and multistakeholder partnership experience. They will also need to be able to provide technical assistance and build capacity for service providers (for example, in areas like partnerships, scaling, and experience with the target community) and other SIB participants. And they will need a collaborative attitude, a willingness to participate in a high-profile partnership, and the fortitude to make hard choices—including hiring and firing service providers in order to ensure that program targets are met.

Two types of organizations appear to have the capabilities required to play the SIB intermediary role. One is **established organizations** designing and implementing programs and regrating funds in the area of community development. The second group consists of **newly formed organizations specifically focused on SIBs**. Social Finance US, for example, is a Boston-based nonprofit established in 2011. Its mission: to structure and manage innovative investment instruments that address the needs of government, nonprofit service organizations, and socially motivated investors and philanthropists. Currently, Social Finance US is entirely focused on being a fully integrated SIB intermediary.

If SIBs are to reach critical mass, however, more intermediaries will be needed. Three groups of actors have the potential to fill this role in the future. In the near term, **financial players**—more specifically, community development financial institutions (CDFIs) and community development venture capital funds—could become SIB intermediaries. Not all the organizations in this category are fully qualified, and it will be critical to work with the best of these organizations, which have

strong financing, project management, and portfolio management expertise—but even the best will need to build or acquire content expertise.

As SIBs evolve, “**content**” **players**—organizations with both place-based and program-specific knowledge and strong ties to the local community (one example would be community foundations)—could play a role. So too could intermediaries selected to manage the federal government’s Social Innovation Fund. These include venture philanthropy funds, foundations, and other charitable organizations that can re-grant capital, raise matching funds, manage a portfolio of programs, and assess results.

Single organizations are most likely to serve the intermediary role in the near term, but a variety of partnerships can be explored in the future. In a **direct partnership**, organizations with complementary capabilities—for instance, a CDFI and program area specialist—might join forces. Through a national facilitator partnership, national groups (such as the Corporation for Supporting Housing) would help spread SIBs by providing capacity building and ongoing technical assistance to local organizations that would serve as intermediaries. And in a **national network model**, local intermediaries would serve under a national brand.

EVALUATORS: TWO DISTINCT ROLES

Each SIB requires two evaluators to fulfill two distinct roles: one is an ongoing adviser to the intermediary and the service provider, the other an arm’s-length auditor that assesses whether the SIB met its performance targets. We have coined the terms “evaluation adviser” and “independent assessor” to describe these two distinct roles. Qualified organizations will likely have very similar skill sets, equipping them to perform either evaluator function, but they will have to choose—and stick with—just one.

The **evaluation adviser**’s involvement begins very early in the SIB’s life cycle. This adviser helps define performance targets, designs the assessment approach, monitors progress, and analyzes and interprets assessment results as a member of the working team. Unlike traditional evaluators, who intentionally keep a certain distance from the intervention, the SIB evaluation adviser will work closely with the project team (composed of the service provider(s) and the intermediary), reviewing interim results and guiding corrective action when necessary.

The **independent assessor** plays a more traditional evaluator role, keeping an arm’s-length distance from the program intervention and maintaining objectivity. When the SIB is structured, the independent assessor signs off on the performance targets, confirming that they can be objectively measured. The assessor then analyzes the results and reports if the SIB is achieving its target outcomes and whether the government is obligated to repay investors. The independent assessor will have a much higher-profile role than typical social sector program evaluators and must be willing to bear the public scrutiny.

Primary qualifications for evaluating SIBs

To evaluate SIBs—whether as an evaluation adviser or an independent assessor—organizations must fulfill three main requirements.

Possess program area expertise. Ideal candidates will have specific content knowledge about the problem the SIB is addressing and be familiar with the evidence-based interventions in that space.

Demonstrate deep evaluation experience. Evaluators must have a proven track record of successfully evaluating social programs through their entire development cycle. They will have experience across the menu of assessment design, data collection, and data analysis options. They will also have familiarity with relevant government data systems. By tapping into their extensive networks, they will be able to build effective teams of internal and external experts.

Be ready and willing. Attitude is just as important as ability. SIB evaluators must be open to partnering with intermediaries and service providers.⁴⁷ They must be comfortable with a high degree of scrutiny and cannot be easily intimidated or afraid to evaluate a high-profile, public-private partnership that's likely to garner significant media attention. Evaluators also need the organizational capacity to take on additional long-term engagements.

The American Evaluation Association, the primary professional association of evaluators, has approximately 7,300 members. The entire membership isn't right for SIBs, but experts believe that at least eight major evaluation firms are appropriate and—just as important—interested in fulfilling this role.⁴⁸ These firms share several characteristics: they are familiar with multiple program areas, have conducted evaluations across the country, possess broad expertise in measuring social outcomes, and have a track record of partnering with governments, academics, and nonprofit service providers.

In addition, think tanks and policy institutes,⁴⁹ experts at universities,⁵⁰ and the evaluators selected for programs supported by the Social Innovation Fund may also be able to serve as SIB evaluation advisers. The bottom line, then, is that we don't expect evaluator capacity to be an issue.

Potential challenges to bear in mind

Even with sufficient capacity, it may still be difficult to assess the programs SIBs help scale. Here, we flag four potential challenges that could affect evaluation and SIBs, and offer some ways to address them.

47 This skill set applies mostly to the evaluation adviser role.

48 Experts identified Abt Associates, American Institutes for Research, ICF Macro, Mathematica Policy Research, MDRC, RAND Corporation, Urban Institute, and Westat.

49 For example, the Vera Institute of Justice.

50 Such as Dennis Culhane at the University of Pennsylvania and Mary Larimer at the University of Washington.

Are there enough players—or potential players—to make it possible for SIBs to become widespread in the United States? The answer seems to be... yes.

Challenges

Social impact assessment is still new. Great strides have been made over the past 30 years, but evaluators still struggle to apply evolving assessment methods to social programs. This problem isn't specific to SIBs, but it will affect them.

Evaluation isn't cheap. Because cash payments are tied to performance targets, SIBs demand rigorous evaluation. Assessment can be costly, and that cost will reduce the pool of taxpayer benefits available for investors and government.

Cost-benefit analysis is key. Social sector evaluators may not have sufficient experience with the cost-benefit analyses critical to assessing SIB taxpayer benefits.

Cultural competency means the world. There is no one-size-fits-all solution—evaluators have to design and implement different assessments for diverse populations.

Mitigation methods

Be flexible and creative. Randomized control trials won't work for most SIB-funded programs. Evaluators will need to explore alternative mixed-method approaches that still allow for comparison of the intervention group with a well-thought-out counterfactual. They will also need to keep evaluation tools simple so as not to overburden the SIB.

Defray costs. Existing government data should be used as the benchmark or baseline for measuring the program's comparison group (assuming government has robust data available). Alternatively, evaluators could seek funding from foundations or the federal government to defray assessment costs.

Boost capacity. Evaluation advisers and independent assessors could bring in external experts to supplement in-house analytical staff.

Enlist experts. Only specialists who know and understand specific target populations can create relevant assessment approaches—and properly interpret the results in context.

Candid or contained? SIBs will be in the spotlight, and a variety of players—the media as well as different stakeholders—will want to know how the programs are progressing. While evaluation findings should be made publicly available in due course, midstream public reporting won't be helpful. Complete transparency mid-intervention could prevent the SIB from achieving its goals. Service providers and intermediaries need flexibility and breathing room to make changes based on ongoing monitoring—and such changes will be difficult to make if the intervention is under a public microscope and subject to constant scrutiny.

ADDITIONAL ENABLERS: FACILITATING SIBS

SIBs cannot become a reality without government, investors, evaluators, and intermediaries, but a number of other players are active and making things happen in the SIB ecosystem.

Philanthropy. The Boston Foundation and The Pershing Square Foundation provided early funding to Social Finance US, helping to build its capacity as a SIB intermediary. The William and Flora Hewlett Foundation, Omidyar Network,⁵¹ and The Rockefeller Foundation⁵² are each developing multifaceted grant portfolios to fund the emerging SIB field. In addition, other foundations have supported McKinsey’s research effort on SIBs including the F.B. Heron Foundation,⁵³ The Robert Wood Johnson Foundation, and the W.K. Kellogg Foundation.

Advisers. Academics like Jeffrey Liebman, the Malcolm Wiener Professor of Public Policy at Harvard University’s Kennedy School of Government, are making important contributions. Liebman wrote *Social impact bonds: A promising new financing model to accelerate social innovation and improve government performance* (Center for American Progress, February 2011) and is currently advising the Commonwealth of Massachusetts as it explores pay-for-success social innovation contracts in chronic homelessness and criminal justice.

Jitinder Kohli is a senior fellow at the Center for American Progress (CAP), a think tank in Washington, DC. Focusing on government efficiency, regulatory reform, and economic issues, Kohli authored “Financing what works: Social impact bonds hold promise,” (November 2010), a paper credited with introducing Washington thought leaders to social impact bonds. He continues to study this emerging field at CAP and recently co-wrote a brief examining SIBs and their value to government agencies: “What are social impact bonds? An innovative new financing tool for social programs” (March 2012).

Other players: The Nonprofit Finance Fund (NFF) is a community development financial institution with 30 years of experience in helping to build the field of innovative social finance. In January 2011, the organization launched a Pay for Success (PFS) Learning Hub (payforsuccess.org) to share information and facilitate online discussion about SIBs. Open to everyone, the hub aims to be a go-to resource for information sharing about all things SIB-related. NFF also co-convened a learning and planning forum—“Pay for Success: Investing in What Works”—with the White House Office of Social Innovation and Civic Participation in October 2011 and released a report on the forum in late January 2012.

Third Sector Capital Partners has stated its interest in working with service providers, funders/ investors, and government agencies and intends to assist in the launch of the SIB/PFS opportunity in the United States.

51 Omidyar Network supports innovative financial products with the potential for massive social impact. It is funding SIBs with investments in Social Finance UK (to develop other countries’ capacity to develop new SIBs) and Social Finance US (to structure the first SIB in the United States).

52 The Rockefeller Foundation funded Social Finance UK to develop the SIB concept and invested in the first pilot in Peterborough, England. In the United States, Rockefeller has funded the Nonprofit Finance Fund’s Pay For Success (PFS) Learning Hub, technical assistance to state and local governments, and a series of issue briefs, articles, and a White House forum to facilitate a bipartisan dialogue with federal policy makers on PFS.

53 F.B. Heron Foundation supports new enterprise finance tools (such as SIBs) that broaden the access of a wide range of social investors to build opportunities in the social sector.

Our research into the SIB ecosystem and our analysis of the interest and ability of the various stakeholder groups—government, investors, intermediaries, and evaluators—have shown that there are competent players who can fulfill distinct roles and meet the specific requirements of SIBs. To be sure, stakeholders face many barriers, but there appears to be a large and growing pool of qualified participants. Capacity should not be a constraint for SIB progress.

4. A pro forma analysis of a juvenile justice SIB

To help stakeholders understand what they can and cannot expect from a SIB, we constructed an analysis of a hypothetical SIB. We sought answers to questions such as: what's the potential for taxpayer benefits? How long will it take to pay back investors? What are the costs inherent in the SIB structure? Our analysis shows how one SIB could play out; it is not in any way representative of SIB economics in general. But we hope our analytical approach, the assumptions we made, and how we applied intervention data will inform the field's understanding of how SIBs can be structured.

OUR SOURCE FOR INTERVENTION DATA

We knew that we would need to make a number of assumptions—but we wanted to anchor our analysis in the best possible intervention data. We relied heavily on analysis from the Washington State Institute for Public Policy (WSIPP),⁵⁴ which conducts nonpartisan research on the effectiveness of state-run programs in a variety of social welfare areas. Although WSIPP did not develop its estimates explicitly to be used as the basis for a SIB analysis, many of the programs WSIPP has examined meet our criteria for scaling with SIBs. (All of WSIPP's analyses are based on costs, benefits, and other specifics for Washington state only.)

WSIPP has made state-of-the-art estimates of the likelihood that programs will achieve outcomes, the cost of service provision, and a program's total benefits to society—including the benefits to taxpayers, constituents who participate in the program, and other members of society (see Chapter 1 for a more detailed description of total benefits to society).

WSIPP's analysis includes estimates of long-term taxpayer benefits per program participant. To estimate annual taxpayer benefits during the SIB life span, we used unpublished cash flow values from Pew's Results First project, which is extending the WSIPP model beyond Washington state.⁵⁵

WSIPP also estimates how government spending fluctuates depending on the number of service recipients. This provides the long-run marginal costs of government remedial services. While these incremental costs can be substantially smaller than the average costs that other organizations tend to compute, they are enormously revealing, providing a more accurate picture of the government savings that are actually realized.⁵⁶

54 Created by the Washington state legislature in 1983 and based in Olympia, the Washington State Institute for Public Policy is a team of policy analysts, economists, university specialists, and consultants. It has studied the cost-effectiveness of state-run programs in high-priority areas including education, criminal justice, welfare, children and adult services, health, utilities, and general government.

55 Results First helps states assess the true costs and benefits of public programs and fosters a decision-making environment that is driven by research and evidence. It is an initiative of the Pew Center on the States and the John D. and Catherine T. MacArthur Foundation, with additional support from the Annie E. Casey Foundation. It is currently partnering with Connecticut, Florida, Idaho, Illinois, Iowa, Kansas, Kentucky, New Mexico, New York, Texas, and Vermont.

56 For example, in its analysis in the field of criminal justice, the Washington State Institute for Public Policy publishes the marginal cost of each kind of crime by government program and department. It then calculates an average of the total taxpayer benefits over the life of a program participant. This average is driven by an underlying model that accounts for which participants conduct fewer crimes, at which points in their lives, what the averted crimes are, and how these translate into reduced resource usage in each part of the criminal justice system.

TARGET INTERVENTION: FUNCTIONAL FAMILY THERAPY

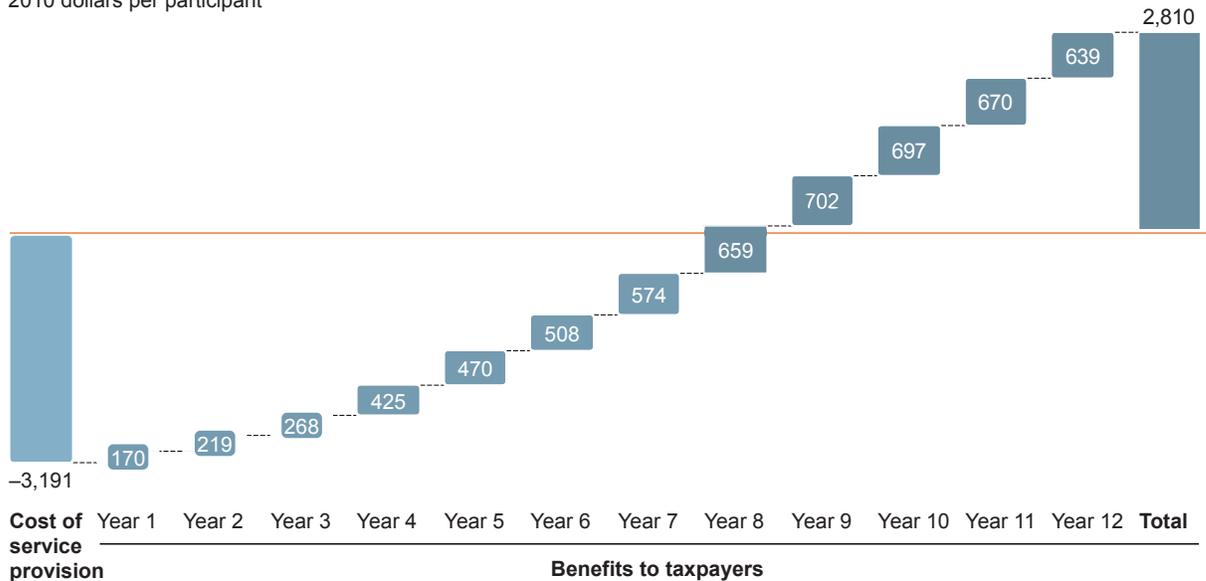
We chose Functional Family Therapy (FFT) as the preventive intervention for our pro forma analysis. FFT is a 12-week in-home family-oriented program delivered by trained therapists. It has a 40-year track record and impressive reach—it is currently delivered at approximately 220 sites worldwide. It also boasts tremendous results: 13 studies document that over a 15-year period, youths participating in FFT had recidivism rates 25 to 60 percent⁵⁷ lower than comparison groups.

Furthermore, compared with other interventions that can be used with juvenile offenders—Multidimensional Treatment Foster Care, Multisystemic Therapy, and Brief Strategic Family Therapy, for example—FFT has one of the highest ratios of taxpayer benefits (approximately \$8,300 per youth) relative to the cost of service provision (approximately \$3,200 per youth). WSIPP also estimates additional quantifiable benefits to society approximating \$30,000; these include participant labor-market earnings and averted victimization costs.⁵⁸

WSIPP charted the cost-benefit time path showing when the net taxpayer benefits generated by one program participant in FFT equal the costs of providing FFT. The program breaks even in year 8, with positive net taxpayer benefits occurring in year 9 (Exhibit 4.1).

Exhibit 4.1: This is the cost-benefit time path of one participant in Functional Family Therapy

2010 dollars per participant



⁵⁷ James Alexander, Bruce Parsons, Christie Pugh et al, *Functional Family Therapy: Blueprints for Violence Prevention, Book Three*, Blueprints for Violence Prevention series, Delbert S. Elliott, ed., Boulder, CO: Center for the Study and Prevention of Violence, Institute of Behavioral Science, University of Colorado, 2000.

⁵⁸ Washington State Institute for Public Policy (WSIPP) estimates are based on a meta-analysis of eight high-quality evaluations and are conservatively adjusted to account for imperfect research findings. WSIPP estimates that without treatment 72 out of every 100 15-year-old youths on probation will recidivate within the next 15 years. The average effect across eight evaluations suggests that Functional Family Therapy reduces recidivism rates by almost a third (31 percent), which WSIPP adjusts down to 17 percent to account for imperfect research methods such as a lack of long-term follow-up.

UNDERSTANDING SIB ECONOMICS

The earliest SIBs will be under intense scrutiny. All involved will want to understand the economics of this new approach, how long the SIB will be in place, when performance milestones will occur, and when government can be expected to repay investors.

To understand the timing for investor repayment, we built off the cost-benefit time path for FFT alone and factored in administrative or overhead costs associated with SIB structuring. We imagined a SIB that delivered FFT to a total of 4,500 youths over three years —one cohort of 1,500 15-year-old youths per year. We made assumptions about the additional costs inherent in a SIB—that is, the fees paid to the intermediary, evaluation adviser, and independent assessor. Factoring in these additional costs, the SIB needs to run until year 12 (nine years after the delivery of the FFT program) to generate a reasonable level of taxpayer benefits, creating savings for government and a return to investors. The result is a 12-year SIB that costs \$16 million.⁵⁹ Exhibit 4.2 lists the assumptions we made in our pro forma analysis.

Exhibit 4.2: Pro forma terminology and assumptions

Term	Definition	Assumption
1. Constituents treated	Number of program participants	1,500 per year for each of first 3 years
2. Cost of service provision	Delivering intervention (e.g., therapist, quality assurance, case management, court processing)	Source: WSIPP ¹ estimates for delivering program to 913 participants in Washington state in FY2008 (\$3,191 per participant)
3. Cost of evaluation advisor	“Hands on” SIB role monitoring progress and suggesting course corrections	5% of the cost of service provision, spread evenly over the years service is provided (~\$240,000 p.a., ~\$720,000 total)
4. Cost of independent adviser	Traditional role of analyzing results and reporting performance	5% of the cost of service provision, spread evenly over every year of the SIB (~\$60,000 p.a., ~\$720,000 total)
5. Management fee to intermediary	Up-front fee to intermediary to coordinate and oversee program delivery	1% of the cost of service provision, spread evenly over the years service is provided (~\$50,000 p.a., ~\$140,000 total)
6. Total cost of SIB	Sum of costs of service provision, evaluation adviser, independent assessor, and management fee	—
7. Principal drawn down	Funds required from investors in each year	Principal drawn down as required over first 3 years (\$16 million total)
8. Benefits to taxpayers	Average benefits from program accruing to taxpayers (e.g., reduced government spending)	Source: WSIPP ¹ model estimates for youths on probation in Washington state provided by Pew’s Results First project
9. Net savings	Benefits to taxpayers remaining after cost of SIB	—
10. Cumulative net savings	Total net savings accrued to date since start of SIB	—
11. Savings to taxpayers	Average benefits to taxpayers retained by government	50% of net savings after costs of service provision and SIB structure (\$4 million total)
12. Success fee to service provider and intermediary	Contingent fee to intermediary/service provider based on program’s success	10% of any returns to investors after principal is repaid (~\$410,000 total)
13. Investor net cash flow	Flow of funds from and to investors in each year based on average benefits to taxpayers	Payouts every 2 years, beginning in year 4, based on realized taxpayer benefits to date
14. Cumulative investor net cash flow	Total investor net cash flow accrued to date since start of SIB	—

⁵⁹ According to Washington State Institute for Public Policy calculations, it takes 8 years for the cumulative taxpayer benefits to equal the cost of delivering Functional Family Therapy (FFT) treatment to one program participant. Our 12-year time frame accounts for the SIB’s overhead costs and three successive waves of FFT participants.

The fact that FFT alone can break even in 8 years, whereas FFT scaled through a SIB needs 12 years to break even, highlights a crucial point: SIBs are a more expensive way to finance the scaling up of preventive programs than if the government simply went directly to service providers and paid them to expand an intervention to more constituents. But while there are cheaper and less complicated ways (such as grants and conventional contracts) to scale programs, we do not see many preventive programs at scale today. This suggests that in order to scale at least some types of programs successfully, government can benefit from support in the form of additional capacity, supplemental expertise, and outside risk capital—all hallmarks of a SIB.

The “premium” inherent in scaling programs through SIBs is justified only if conventional options aren’t working and if the SIB structure is adding value commensurate with its cost. SIBs are also worth the premium if they do more than simply support the scaling of a discrete intervention—that is, if they help usher in new ways for social sector actors to align their priorities and play their roles more effectively and efficiently. SIBs appear to have potential to spur cooperation and help transform performance in the social sector.

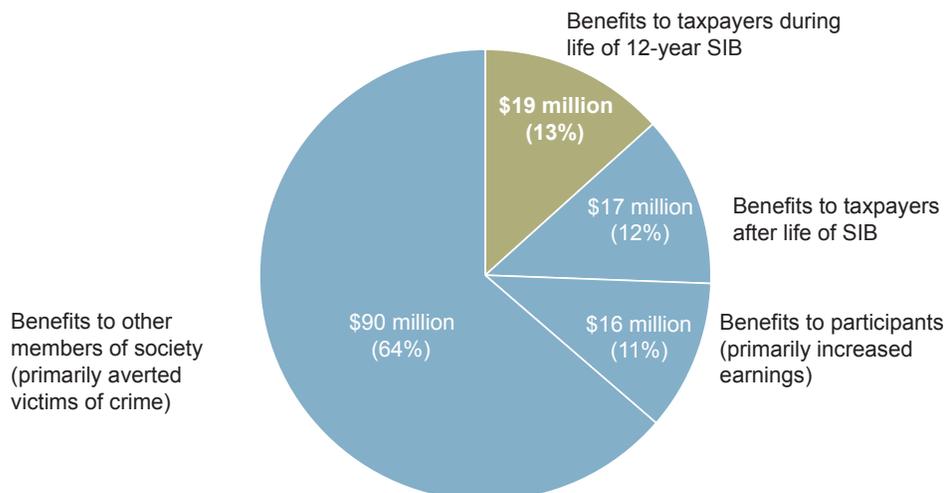
We determined the present value of all total benefits to society generated from scaling FFT for 4,500 participants to be \$142 million, of which \$36 million is taxpayer benefits (Exhibit 4.3). However, our pro forma analysis indicates that for each FFT participant, only 58 percent of these taxpayer benefits (\$19 million) are actually realized within 12 years of the intervention. The remaining 42 percent (\$17 million) will be realized only after year 12.

Exhibit 4.3: Functional Family Therapy SIB pro forma: present value of all benefits to society

2010 dollars, inflation adjusted and discounted at 3.5% real interest rate

Present value of total benefits to society: \$142 million

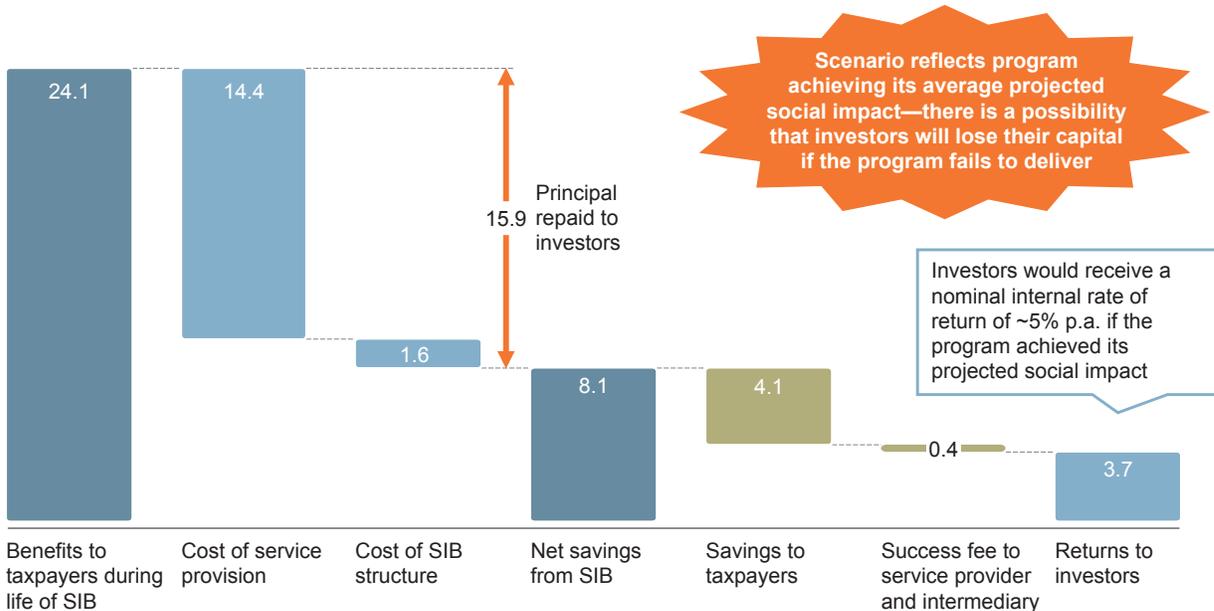
- SIB can capture benefits worth \$19 million in present value, which is \$24 million in undiscounted current value
- Benefits are primarily due to reduced use of prisons and other elements of criminal justice system



The earliest SIBs will be under intense scrutiny. All involved will want to understand the economics of this new approach, how long the SIB will be in place, when performance milestones will occur, and when government can be expected to repay investors.

Exhibit 4.4: Functional Family Therapy SIB pro forma: projected returns

2010 millions of dollars per participant (inflation adjusted, undiscounted)



This has obvious implications for investors, as their repayment is tied to taxpayer benefits (which come from lower incarceration rates, increased taxes, and lower health care costs attributed to increased educational attainment). It also illustrates that financial savings to government and financial returns to investors cannot be the only motivator for SIBs. Indeed, social impact must drive SIB stakeholders because the short-term financial argument alone considers only a fraction of the full value created through interventions with long-term impact.

It is also important to acknowledge that savings may exist in the system but may not be realized for reasons beyond the control of the SIB organizers. For example, government may not be able to aggregate savings across agencies and ring-fence it. Or government could decide to redeploy the savings to help people who had been underserved in the past when facilities were at capacity. A SIB might reduce the need for beds among a specific group of targeted constituents, for instance, but government could decide to fill those beds with new populations.

If the FFT intervention achieves its expected average outcome and yields \$24 million in taxpayer benefits (undiscounted current value), investors would receive a nominal internal rate of return of approximately 5 percent per annum (Exhibit 4.4).⁶⁰

DIFFERENT INTERVENTION, DIFFERENT TIME FRAME

At 12 years, the time frame for repaying investors in this pro forma analysis (Exhibit 4.5) is long by the standards of many interested in the SIB approach. We doubt a 12-year SIB will be palatable to investors, government, or other stakeholders in the near future—even if the SIB were structured like our pro forma analysis (that is, with multiple cohorts, allowing early progress to be visible). We expect that 4 to 6 years will be the longest time frame an early SIB is likely to stretch.

SIBs are worth pursuing, and their potential can be realized because the right conditions are already in place, but turning potential into action will require great effort

⁶⁰ Assumes a 2 percent per annum inflation rate.

Exhibit 4.5: Functional Family Therapy SIB pro forma: breakeven for investors occurs in year 12

Thousands of 2010 dollars (inflation adjusted, undiscounted)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Total
1. Constituents treated	1,500	1,500	1,500	0	0	0	0	0	0	0	0	0	4,500
2. Cost of service provision	4,787	4,787	4,787	0	0	0	0	0	0	0	0	0	14,360
3. Cost of evaluation adviser	239	239	239	0	0	0	0	0	0	0	0	0	718
4. Cost of independent assessor	60	60	60	60	60	60	60	60	60	60	60	60	718
5. Management fee to intermediary	48	48	48	0	0	0	0	0	0	0	0	0	144
6. Total cost of SIB	5,134	5,134	5,134	60	60	60	60	60	60	60	60	60	15,939
7. Principal drawn down	5,134	5,134	5,672	0	0	0	0	0	0	0	0	0	15,939
8. Benefits to taxpayers	255	584	986	1,368	1,745	2,105	2,328	2,612	2,903	3,087	3,104	3,009	24,083
9. Net savings	-4,879	-4,550	-4,148	1,308	1,685	2,045	2,268	2,552	2,843	3,027	3,044	2,949	8,143
10. Cumulative net savings	-4,879	-9,429	-13,577	-12,268	-10,584	-8,539	-6,271	-3,719	-877	2,151	5,194	8,143	-
11. Savings to taxpayers	43	99	167	231	295	356	394	442	491	522	525	509	4,074
12. Success fee to service provider and intermediary	0	0	0	0	0	0	0	0	0	0	0	407	407
13. Investor net cash flow	-5,134	-5,134	-5,672	2,652	0	3,198	0	4,104	0	4,976	0	4,671	3,662
14. Cumulative investor net cash flow	-5,134	-10,267	-15,939	-13,287	-13,287	-10,089	-10,089	-5,985	-5,985	-1,009	-1,009	3,662	-

It is important to note that the time frame for capturing taxpayer benefits varies depending on the nature of the intervention. An intervention like the one assumed in our pro forma analysis—FFT administered to 15-year-olds on probation—will pay off over the lifetime of the program participants. There is a typical age range when youth are most likely to recidivate, and that period goes beyond the four- to six-year time frame of an ideal SIB.

In contrast, a SIB focused on scaling up Permanent Supportive Housing would begin to yield benefits almost immediately, because chronically homeless people housed in a safe and healthy environment would stop going to shelters and emergency rooms as soon as their living situation was stabilized. The cost-benefit time path would be much shorter due to the specific characteristics of the problem and its solution.

WHAT THE ANALYSIS TELLS US ABOUT SIBs IN GENERAL

It bears repeating that this pro forma analysis illustrates only one SIB and does not represent SIB economics in general.⁶¹ It is not yet clear what the market will bear when it comes to intermediary management fees, success fees for the intermediary and for the nonprofit service providers, fees

⁶¹ Some respondents to the Massachusetts request for response have indicated they plan to develop pro forma analyses as part of their submission and make them public.

for evaluation advisers and independent assessors, investor returns, and how government will share benefits with the other SIB parties. We made assumptions based on the extensive interviews we conducted with relevant stakeholders, but the first SIBs won't necessarily bear them out. Like any negotiated transaction, there is likely to be a gap between theory—no matter how thoughtful the model analysis is—and reality. Each SIB—especially in the early years—will be negotiated and structured in a bespoke fashion.

The scale of the intervention matters to the economics of a SIB. In a jurisdiction where the number of constituents for a given intervention falls below a certain threshold, a SIB may not “work.” The biggest cost savings occurs not when fewer constituents are served, but rather when the need to serve constituents is decreased substantially—for example, when an entire prison or other capital facility can be closed down. For this reason, looking at costs on a per person or incremental basis can be misleading.

Because SIBs are both location- and program-specific, our estimates of taxpayer benefits apply only to Washington state and FFT within the juvenile justice space. Costs for preventive and remedial programs differ significantly by jurisdiction and intervention areas. Consequently, the total taxpayer benefits and the time frame in which those benefits are realized will also differ significantly. What does this mean? Stated simply, there are no shortcuts when it comes to analyzing SIBs. In jurisdictions where the cost-benefit analysis on a given intervention has not yet been done, there will be important work to do even before the process of structuring the SIB begins.

What's the potential for taxpayer benefits? How long will it take to pay back investors? What are the costs inherent in the SIB structure? Our analysis shows how one SIB could play out...

5. Conclusion

Our research suggests that SIBs have specific benefits and that the right conditions are in place today to implement SIBs: evidence-based social interventions already exist, there is sufficient stakeholder capacity, and there is real interest and momentum to make SIBs a reality. But turning potential into action will require a clear choice to move ahead and concerted effort to implement this new tool: stakeholders must overcome several challenges, a number of proof points must be demonstrated, and making SIBs more widespread will require some standardization.

In this final chapter, we explore what needs to happen for SIBs to succeed, if stakeholders choose to use them. And we acknowledge SIBs as one part of a broader conversation about public-private collaboration and innovation to serve people and communities better.

REQUIREMENTS FOR A CONDUCTIVE ENVIRONMENT

All new markets require a great deal of initial work, and SIBs are no exception. If SIBs are to gain traction as a new tool, the first few SIBs must be executed carefully and well, and not done just for novelty's sake. More specifically, ensuring a successful conclusion to the SIB story will require stakeholders to take three specific actions.

Clear up confusion through a robust education and communications plan.

A strong, well-coordinated effort to inform stakeholders about what SIBs are—and are not—will prove invaluable. This effort will need to be led by intermediaries, with assistance from advisers, academics, and the media. There are three key messages to communicate. **It's new:** Fear of the unknown could present a problem, and stakeholders will need to get comfortable with the new SIB structure and risk-return profile. Similarly, SIBs will be unfamiliar to many because the model hinges on a multistakeholder partnership. **It's complicated:** Because they won't be accustomed to "taxpayer benefits" as the underlying source of return, investors will need to gain confidence that government will make payments. **It's not a bond:** Investors and others still struggling to wrap their heads around SIBs are distracted and confused by the word "bond," which is a misnomer.

Recognize SIBs as a tool for scaling up social benefits.

SIBs intend to replace a more expensive, less effective remedial program with a less expensive, more effective preventive program. On its face, this plan should save money and generate taxpayer benefits. But SIBs won't fund government deficits and won't help investors get rich quick. Great financial expectations will likely produce great disappointment. **What SIBs can do:** SIBs can catalyze a number of positive reactions: they can generate more effective results, help government shift its focus from remediation to prevention, and realign government operations. **What SIBs (probably) can't do:** SIBs are not universally appropriate for all program areas, governments, or investors; they aren't the easiest way for direct service providers to fund expansion; and they're not a source of free money that can be used to subsidize government coffers. **Assessing investor appetite:** Financial returns to investors will also vary in timing and magnitude. Because the risk of principal loss is unlikely to ever be offset by the potential financial upside, only investors who care about the social bottom line to some extent are likely to care about SIBs.

Design and implement with care.

SIBs aren't plug and play. Although each SIB must be custom designed, all SIBs will benefit from several key considerations. **Cooperation is king:** A SIB will function effectively only if every stakeholder is willing and able to uphold its end of the deal and fulfill its unique roles and

responsibilities. Stakeholders must be on the same page; their interests must be aligned and compatible. **Success requires effective project management:** Like any multistakeholder partnership, SIBs require participants to make a substantial investment of time and energy. Relationships among stakeholders must also be managed—this is important throughout the process, but especially so when things don't go according to plan. SIBs are more likely to achieve their goals if tracking, course correction, and project management are all part of the process. **Pledge allegiance but be flexible:** Successful scaling involves delivering a proven program, faithfully adhering to its core components, and conducting staff training, quality control, and monitoring. It's important to ensure fidelity, but it is also critical to adapt interventions for specific constituents and contexts. Indeed, local knowledge and cultural nuance must guide the intervention, even as the basic principles remain consistent. **Flexibility and credibility are important when it comes to evaluation:** Social intervention evaluations are inherently complicated and time-consuming, but the high-stakes nature of SIBs—outcomes are tied to cash payments—means they're also likely to be costly. To make evaluations less expensive, SIBs can select proven interventions and investigate cost-conscious evaluation methodologies. Utilizing administrative data, for example, might save money on the evaluation costs of the SIB. Another idea is to obtain separate evaluation funding from foundations or from the federal government to defray high costs. Foundations that can't make program-related investments but want to support SIBs may be interested in helping to defray evaluation costs. But interest may not result in action: hindered by reduced endowments, many foundations are contending with decreased evaluation budgets.

A TALL ORDER: THE FIRST WAVE OF SIBS MUST DEMONSTRATE A NUMBER OF NEAR-TERM PROOF POINTS TO JUSTIFY SCALING

- ✓ **Pilots in multiple jurisdictions** to demonstrate that SIBs work in different cost environments; under centralized and decentralized government structures; and under a range of conditions such as different procurement rules and different government data collection standards
- ✓ **Pilots in multiple program areas** to demonstrate that SIBs work across various evidence-based programs; in different assessment and data situations; with a range of service providers and evaluators; and under a range of government funding schemes
- ✓ **Diversity of SIB investors beyond purely philanthropic funding** to demonstrate that impact investors have potential demand for SIBs and that SIBs will not cannibalize grant funding
- ✓ **Clear evidence of social outcomes** to demonstrate successful scaling of evidence-based programs with SIBs and the ability of programs to reach performance targets
- ✓ **Proof of decreased use of remedial services** due to successful scaling of preventive interventions under SIBs, to demonstrate the basis for government savings regardless of whether the savings can be successfully coordinated and captured
- ✓ **Track record of payments to investors** to demonstrate that government will uphold its responsibility for this nontraditional instrument that is likely to be subject to annual appropriations, and to show coordination among agencies for savings and repayment

SIB SCALING WILL REQUIRE STANDARDIZATION

It won't be difficult to generate initial interest in SIBs—a number of first movers are eager to conduct early test drives—but the real challenge will be gaining traction once the novelty wears off. Early SIBs are all likely to be unique. For now, if you've seen one SIB, you've seen one SIB. This makes spreading the model difficult. A little standardization will go a long way.

All nascent markets benefit from standards, norms, and common tools that help maximize efficiency and scale. SIBs are no exception. While they will always be relatively bespoke, SIBs will benefit from standardization as soon as—and wherever—possible. Some of what's needed is upstream, related to the program intervention, while other enablers relate to the SIB model itself. Stakeholders interested in advancing SIBs can do so by helping to create standards in the following areas:

Best practice methods for cost-benefit analysis. The economics of an evidence-based program intervention will be different in different parts of the country. To determine if a SIB has potential, the financial and social costs and benefits must be examined for the specific community being explored. Once the costs and benefits have been modeled for an intervention in one locale, sharing the methodology will allow other cities and states to run the numbers more quickly and motivate them to consider bringing a SIB to their backyard.

Scoping new program areas and geographies. Each time SIBs move into a new program area—from homelessness and criminal justice to health or education, for example—there will be a steep learning curve. Stakeholders will need to do thorough research on which interventions have the strongest evidence base, the complexities of relevant government funding systems, the capacity of specialist service providers, and evaluators and intermediaries with germane expertise. Their findings will be different in each city and state. Communities of practice—or other flexible models that allow peers to share information and consult one another with targeted questions—could facilitate this process.

Diagnostics, due diligence, term sheets, and more. Stakeholders considering if they are right for SIBs, and if SIBs are right for them, need diagnostic tools to get started and due-diligence tools to assess potential partners in a thorough and consistent manner. (We have developed rapid suitability questionnaires and a due-diligence review of partner capabilities; these tools will be available at payforsuccess.org.) As new SIB deals close, intermediaries and others will be under pressure to balance the importance of maintaining their intellectual property with the value to the field of making term sheets and report formats publicly available so that each SIB doesn't have to reinvent the wheel.

SIB partnership care and feeding. Each SIB will likely involve a new group of stakeholders and will have to break down a new set of silos. General best practices about building and maintaining partnerships will only go so far. Specific lessons learned about what it takes to make a SIB partnership successful, and how to track, calculate, and aggregate costs and savings across government agencies will be invaluable. SIB pioneers can help other stakeholders by reflecting on what works and what doesn't, and sharing their experience.

LOOKING TO THE FUTURE

Because SIBs are so new, much remains to be seen. The jury is still out on whether SIBs will gain traction as a tool for scaling social programs. And new market development is inherently messy. While we don't presume to predict what will happen next with SIBs, we have given some thought to questions that are beyond the scope of our research, and remain open:

- **Financing and funding?** Will SIBs become a permanent part of the government financing landscape? When a SIB matures, how will the preventive program be funded?
- **A true transition?** If SIBs successfully demonstrate the benefits of preventive programs, what will happen next? Will government fund additional preventive programs by contracting directly with service providers? And will the ongoing assessment and summative evaluation be maintained?
- **More toward the middle?** If government sees the value and savings attributed to preventive programs, will it begin to issue traditional municipal bonds to provide financing or follow the state of Minnesota's approach?
- **A new era?** Will SIBs advance a government focus on outcomes, interdepartmental and agency collaboration, and evidence-based approaches to social solutions?

The first few SIBs may look quite different from one another and are not likely to be structured and implemented in an identical fashion. There is real value in being open to and experimenting with a range of models and results. Stakeholders should consider that success may mean different things and manifest in different ways. One SIB may receive high marks if it delivers social outcomes but doesn't realize cashable government savings. Another, very different SIB could demonstrate utility for a select group of program areas but prove inefficient for other fields. Flexibility is key.

Catalyzing change

As we have observed throughout this report, SIBs are a comparatively expensive way to scale a program, and for that reason not every proven program should necessarily be scaled through a SIB. This means SIBs must be carefully deployed to serve a bigger purpose.

We have invested in this study of SIBs because we see them as part of a broader effort to transform the social sector to better serve the needs of people and their communities. Whether or not SIBs become a popular approach to scaling interventions, they have already generated excitement and enthusiasm for finding new ways to address persistent social problems. The model's basic tenets—increased multistakeholder collaboration, focus on results, appropriate risk allocation, and alignment of incentives—are key to addressing myriad social sector challenges.

SIBs are highly relevant for catalyzing the right kind of conversation, promoting innovative responses to social problems, and linking impact with the resources that can make a real change in the world. If SIBs galvanize a new wave of innovation and pave the way for other alternative models, their impact will be truly meaningful.

Acknowledgements

Our work has been supported by grants from The F. B. Heron Foundation, The William and Flora Hewlett Foundation, The Robert Wood Johnson Foundation, The W.K. Kellogg Foundation, Omidyar Network, and The Rockefeller Foundation.

Advisory group

Amit Bouri, Global Impact Investing Network
Cathy Clark, Center for the Advancement of Social Entrepreneurship, The Fuqua School of Business, Duke University
Joel Copperman, Center for Alternative Sentencing and Employment Services
Kristin Giantris, Nonprofit Finance Fund
Steve Goldberg, Social Finance US
Megan Golden, Robert F. Wagner Graduate School of Public Service, New York University
John Goldstein, Imprint Capital
Rosanne Haggerty, Community Solutions
Lisa Hall, Calvert Foundation
David Hunter, Hunter Consulting
Jitinder Kohli, Center for American Progress
Patrick Lawler, Youth Villages
Natasha Lifton
JoAnne Page, Fortune Society
Tracy Palandjian, Social Finance US
Drew von Glahn, Third Sector Capital Partners

Steering committee

The F.B. Heron Foundation: Clara Miller
The William and Flora Hewlett Foundation: Jacob Harold
The Robert Wood Johnson Foundation: Nancy Barrand
Omidyar Network: Stephanie Cohn, Amy Klement
The Rockefeller Foundation: Kippy Joseph, Justina Lai

Thought leaders

Abt Associates: Brooke Spellman
Acumen Fund: Brian Trelstad
Bloomberg Philanthropies: James Anderson
The Boston Foundation: Leo Quigley
Bowery Residents' Committee: Muzzy Rosenblatt
Calvert Foundation: Catherine Godschalk, David Kyle
Annie E. Casey Foundation: Nathaniel Balis, Tracy Kartye, Tom Kelly, Justin Milner
Center for Employment Opportunities: Mindy Tarlow
Center for the Advancement of Social Entrepreneurship, Duke University, The Fuqua School of Business: Paul Bloom, Greg Dees

Centers for Medicare and Medicaid Services: John Klemm, Christopher Truffer
Children's Aid Society: Bill Weisberg
City of Atlanta, Office of the Mayor: Duriya Farooqui
City of Detroit, Finance Department: Cheryl Johnson
City of Louisville, Office of the Mayor: Sadiqa Reynolds
City of New York, Health & Human Services: Linda Gibbs, Kristin Misner
City of Newark, Office of the Mayor: Anthony Santiago
City of Newark, Office of Reentry: Ingrid Johnson
Robert Sterling Clark Foundation: Margaret Ayers, Laura Wolff
Coalition for Evidence-Based Policy: David Anderson, Jon Baron
Commonwealth of Massachusetts, Executive Office for Administration and Finance: Greg Mennis
Commonwealth of Virginia, Office of the Governor: Larry Wilder
Community Development Venture Capital Alliance: Kerwin Tesdell
Corporation for Supportive Housing: Deborah De Santis, Ryan Moser
The Doe Fund: David Howard, George McDonald
The Edna McConnell Clark Foundation: Liz Bender, Chuck Harris
Enterprise Community Partners, Inc.: Abby Jo Sigal
Evaluation Roundtable at Public/Private Ventures: Patti Patrizi
FSG: Hallie Preskill
Foundation Center: Larry McGill, Bradford Smith
The Bill & Melinda Gates Foundation: Orin Hasson, Darin McKeever, Kollin Min
Godeke Consulting: Steven Godeke, Lyel Resner
Growth Philanthropy Network and the Social Impact Exchange: Simon Jawitz, Cynthia Massarsky
Harvard University: Shawn Cole, Jeffrey Liebman, Christa Velasquez
Homeward: Kelly King Horne
ImpactAssets: Jed Emerson, Tim Freundlich
Invest in Outcomes: Steve Rothschild
John Jay College of Criminal Justice: Jeffrey Butts
The Robert Wood Johnson Foundation: Jane Lowe
Justice Policy Institute: Amanda Petteruti
The W. K. Kellogg Foundation: Tony Berkley, Ted Chen, John Duong
The Kresge Foundation: Kimberlee Cornett, Guillermina Hernandez-Gallegos, Rip Rapson
The John D. and Catherine T. MacArthur Foundation: Debra Schwartz
MaRS Centre for Impact Investing: Adam Jagelewski
Massachusetts Housing and Shelter Alliance: Tom Brigham, Joe Finn
MDRC: Lashawn Richburg-Hayes
Medical University of South Carolina: Scott Henggeler
Mission HUB LLC: Penelope Douglas
National Alliance to End Homelessness: Steve Berg, Amanda Krusemark Benton,
Sharon McDonald, Kate Seif, Lisa Stand, Norm Suchar, Pete Witte
New York State Health Foundation: Brian Byrd
Nonprofit Finance Fund: Bill Pinakiewicz, Emily Triggs
Office of Management and Budget: Gary Glickman, Meg Massey, Kathy Stack,
Mary Ellen Wiggins
Office of Social Innovation and Civic Participation, The White House: Jonathan Greenblatt
Omidyar Network: Chris Bishko
Edward Pauly

The Pershing Square Foundation: Paul Bernstein
The Pew Center on the States: Sara Dube, Gary VanLandingham
Potrero Impact Advisors: Daniel Crisafulli
Robin Hood Foundation: Dana Archer-Rosenthal, Emma Bloomberg, Steven Lee,
Deborah McCoy, Kristin Barlup Toombs
Roca, Inc.: Molly Baldwin
Seedco Financial: Edwin Hong,
Sonal Shah
Social Finance UK: Toby Eccles, David Hutchison
State of Connecticut, Office of the Governor: Deb Heinrich
State of Michigan, Office of the Governor: Joseph Pavona
State of Minnesota, Dakota County Community Services: Kelly Harder
State of Minnesota, Olmsted County Community Services: Paul Fleissner
State of New York: Joseph Shields
State of Rhode Island, Department of Corrections: Roberta Richman, A.T. Wall
Strategic Grant Partners: Joanna Jacobson
TCC Group: Peter York
US Department of Housing and Urban Development: Christopher Rupar
United States Interagency Council on Homelessness: Jason Kravitz
United Way of the Bay Area: Anne Wilson
University of Maryland: Douglas Besharov
University of Pennsylvania: Thomas Byrne, Dennis Culhane
University of Washington: Richard Catalano
The Urban Institute: John Roman
Vera Institute of Justice: Christian Henrichson
Washington State Institute for Public Policy: Steve Aos
Youth Villages: Jessica Foster

Homelessness technical appendix

Here, we present the objective, scope, and methodology of our efforts to estimate national government spending on remedial homeless programs.

Objective

- Our estimates are intended to approximate current government remedial spending on homelessness at the federal, state, and local levels

Scope

- US homeless population
- Total government spending at the federal, state, and local levels (excludes nongovernment spending, such as donations from charitable organizations)
- We included spending on remedial programs but not preventive programs
 - Remedial expenditures include spending on homeless (e.g., shelters)
 - Preventive expenditures address spending on:
 - Populations at risk of becoming homeless (e.g., rental voucher programs)
 - Formerly homeless populations (e.g., Permanent Supportive Housing programs)

Methodology

- Using federal figures, agency Web sites, research reports, and expert interviews, we identified the major components of national homelessness spending and classified them under targeted programs or mainstream programs. We then calculated total expenditures for each category
- We estimated total spending for 2010, the most recent year from which data are available

We used separate approaches to calculate targeted and mainstream spending.

A Targeted spending

- Targeted programs are specifically designed for individuals or families **experiencing homelessness**
- Through a USICH¹ report, we obtained **2010 federal spending estimates** on targeted programs and classified them as **preventive or remedial** (we used expert interviews to verify these classifications)
 - For Continuum of Care (COC) federal HUD¹ programs, a 2010 report estimated that ~61% of COC spending was preventive
- We then applied **state/local matching ratios** to all federal remedial programs to determine total government spending on targeted remedial programs

B Mainstream spending

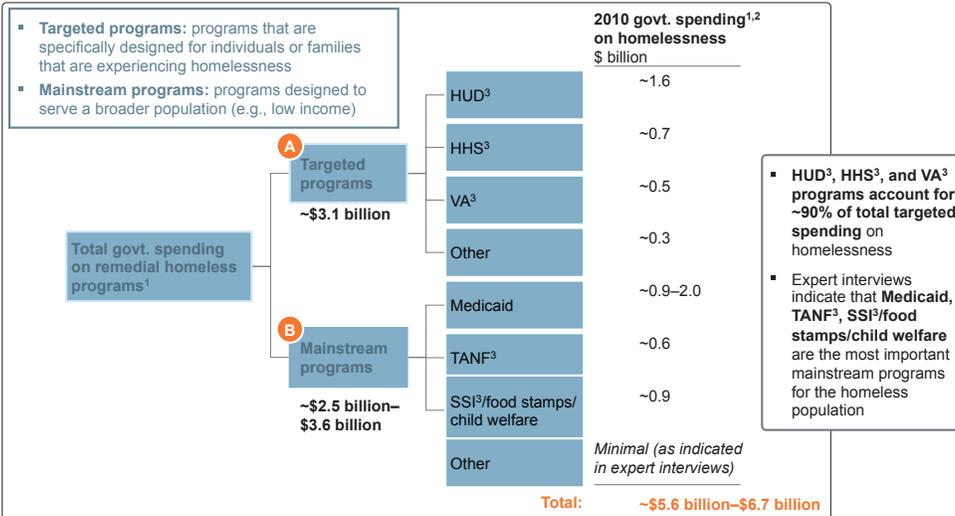
- Mainstream programs are programs designed to **serve a broader population** (e.g., low income)
- We focused on Medicaid, TANF¹, and SSI¹/food stamps/child welfare, as expert interviews indicated that these programs account for a **majority of mainstream homelessness spending**
 - We segmented the homeless population (e.g., chronic vs nonchronic or individuals vs families) and calculated **cost per user for each segment**
- Expert interviews indicate that spending on other mainstream programs was relatively small and since we could not obtain data to approximate spending for these programs, we took a **conservative approach and assumed this other mainstream spending to be minimal**

In addition to expert interviews, we also used various published reports

- *Opening Doors: Federal strategic plan to prevent and end homelessness: Update 2011* (including appendix), USICH¹
- *The 2010 annual homelessness assessment report to Congress*, HUD¹
- 2010 Continuum of Care Assistance Program Grants Awards, HUD¹
- Melford J. Henderson and Stephen W. Hwang, *Health care utilization in homeless people: Translating research into policy and practice*, HHS¹
- *Homeless assistance program funding: Federal versus state and local assistance*, July 2011, NAEH¹

¹ USICH = US Interagency Council on Homelessness; HUD = US Department of Housing and Urban Development; TANF = Temporary Assistance to Needy Families; SSI = Supplemental Security Income; HHS = US Department of Health and Human Services; NAEH = National Alliance to End Homelessness.

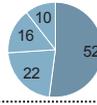
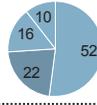
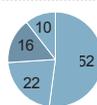
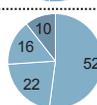
Our estimate for total 2010 federal, state, and local government spending on remedial homeless programs is approximately \$6 billion to \$7 billion.



Note: Numbers may not add exactly due to rounding.
 1 Government spending includes only remedial expenditures and not preventive expenditures (for example, does not include programs to prevent low-income individuals from becoming homeless or any spending on Permanent Supportive Housing and related services).
 2 Government spending includes sum of federal, state, and local government spending on homeless population.
 3 HUD = US Department of Housing and Urban Development; HHS = US Department of Health and Human Services; VA = US Department of Veterans Affairs; TANF = Temporary Assistance to Needy Families; SSI = Supplemental Security Income.

Source: Secondary research; expert interviews; McKinsey analysis

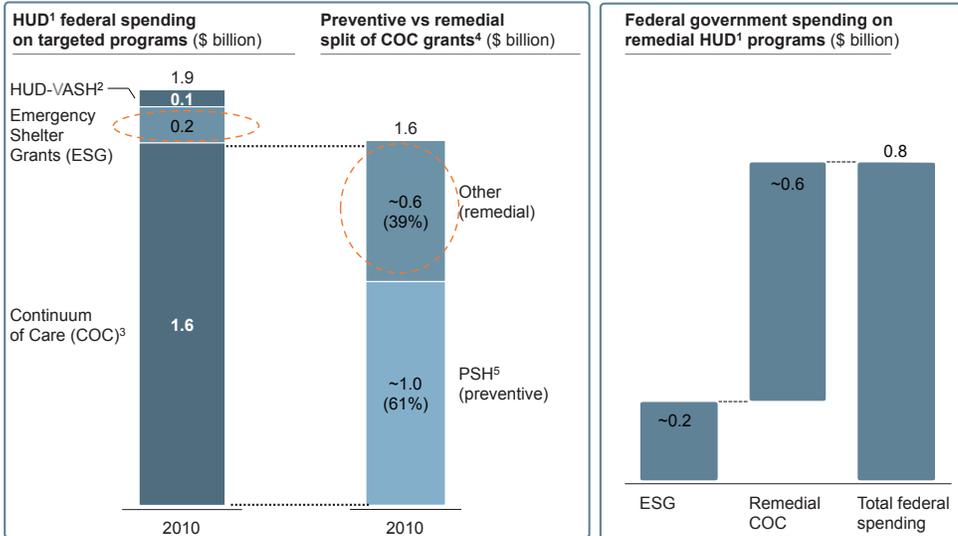
A Total government spending on remedial homeless programs is approximately \$3.1 billion.

	2010 federal spending (\$ billion)	State/local matching ratio ¹ %	2010 total government spending (\$ billion)	% of total targeted spending	Comments
A1 HUD²	0.8	~100	~1.6		<ul style="list-style-type: none"> ▪ ~61% of HUD² Continuum of Care funds are spent on Permanent Supportive Housing and thus excluded from estimate ▪ HUD² expenditures are generally matched at a 1:1 ratio by state and local funding³
A2 HHS²	0.4	~70	~0.7		<ul style="list-style-type: none"> ▪ ~50% of HHS² targeted program funds are for Health Care for the Homeless program ▪ Most HHS² programs matched at a 1:1 ratio by state and local funding except for the Runaway and Homeless Youth Act
A3 VA²	0.5	~2	~0.5		<ul style="list-style-type: none"> ▪ Veterans account for ~12% of the homeless population ▪ Most nonfederal VA² funding comes from private sources (minimal state/city matching)
A4 Other	0.3	~0	~0.3		<ul style="list-style-type: none"> ▪ Includes programs under other federal departments (i.e., DHS, ED, DOJ, DOL)⁴ ▪ Over 60% of other targeted program funds are for the DHS Emergency Food and Shelter program
Total	~2.0		~3.1		

Note: Numbers may not add due to rounding.
 1 Based on expert estimates.
 2 HUD = US Department of Housing and Urban Development; HHS = US Department of Health and Human Services; VA = US Department of Veterans Affairs.
 3 Direct match is slightly lower than 1:1 but ratio takes into account other state and locally funded programs.
 4 DHS = US Department of Homeland Security; ED = US Department of Education; DOJ = US Department of Justice; DOL = US Department of Labor.

Source: Secondary research; expert interviews; McKinsey analysis

A1 Our estimate for federal spending on remedial HUD programs is ~\$0.8 billion.



1 US Department of Health and Human Services.
 2 HUD-VASH = HUD-veterans Affairs Supportive Housing program.
 3 Continuum of Care programs include Permanent Supportive Housing, Shelter Plus Care, and Section 8 Mod Rehab/SRO.
 4 Split between Permanent Supportive Housing and other programs for Continuum of Care (COC) grants obtained from COC dashboard reports (www.hudhre.info).
 5 Permanent Supportive Housing.
 Source: Appendix to *Opening Doors: Federal strategic plan to prevent and end homelessness: Update 2011*; Continuum of Care dashboard reports (www.hudhre.info); expert interviews; McKinsey analysis

A2 A3 A4 Total federal spending on remedial non-HUD programs is approximately \$1.2 billion.

Targeted program	Federal spending (\$ million)	Preventive/remedial
HHS¹		
▪ Health Care for the Homeless	171	Remedial
▪ Runaway and Homeless Youth Act	116	Remedial
▪ Projects for Assistance in Transition from Homelessness	65	Remedial
▪ Grants for the Benefit of Homeless Individuals	43	Remedial
▪ Services in Supportive Housing Grants	35	Preventive
▪ Total HHS	429	
VA¹		
▪ Domiciliary Care for Homeless Veterans	176	Remedial
▪ Homeless Providers Grant and Per Diem Program	175	Remedial
▪ Health Care for Homeless Veterans	110	Remedial
▪ Supportive Services for Veteran Families	20	Preventive
▪ Veterans Justice Outreach Initiative	5	Remedial
▪ Total VA	486	
Other		
▪ DHS ¹ : Emergency Food and Shelter Program	200	Remedial
▪ ED ¹ : Education for Homeless Children and Youth	65	Remedial
▪ DOL ¹ : Homeless Veterans Reintegration Program	36	Remedial
▪ DOJ ¹ : Transitional Assistance Housing Program	17	Remedial
▪ DOL ¹ : Veterans Homeless Prevention Demonstration Program (HUD ¹ , VA ¹)	15	Preventive
▪ DOL ¹ : Stand Downs (grants)	1	Remedial
▪ Total other	335	

Federal spending on remedial non-HUD¹ programs is ~\$1.2 billion

1 HHS = US Department of Health and Human Services; VA = US Department of Veterans Affairs; DHS = US Department of Homeland Security; ED = US Department of Education; DOL = US Department of Labor; DOJ = US Department of Justice; US Department of Housing and Urban Development.
 Source: Appendix to *Opening Doors: Federal strategic plan to prevent and end homelessness: Update 2011*; expert interviews; McKinsey analysis

B Utilizing bottom-up and top-down approaches, we estimated Medicaid spending to be approximately \$0.9 billion to \$2 billion.

Spending by constituent type					
Bottom-up approach (primary)	2010 Medicaid costs for homeless	Chronic	Not chronic: persons in families	Not chronic: individuals	Total
	No. of constituents (Thousand)	110	242	298	650
	% enrolled and using Medicaid	~100 ¹	~70	~20	~50
	Annual cost per user (\$)	~12,000	~3,300	~2,500	~6,000
	Total 2010 spending on homeless (\$ billion)	1.3	0.6	0.1	2.0

% of mainstream homeless spending		
Top-down approach (secondary)	2010 Federal Medicaid spending on homeless (\$ billion)	0.6
	Federal spending as % of total spending	~68 ²
	Total 2010 spending on homeless (\$ billion)	0.9

Expert interviews indicate Medicaid spending on homeless to be ~\$1.5 billion–\$2 billion

Note: Figures may not add exactly due to rounding.

¹ Includes pre-enrolled, "presumptively eligible," and ineligible population, which comprises ~100% of chronic homeless population.

² Assumes same federal/state/local split for homeless as for all of Medicaid.

Source: Department of Health and Human Services Web site on Medicaid; appendix to *Opening Doors: Federal strategic plan to prevent and end homelessness: Update 2011*; secondary research; expert interviews; McKinsey analysis

B TANF spending on homeless-family households is approximately \$0.6 billion.

2010 TANF ² spending on remedial homeless programs		Number of homeless family HHs	% of homeless family HHs that use program ¹	Monthly spending/HH	Annual TANF ² spending
		Thousand		\$ ¹	\$ billion
	Child care	~79	~15	~2,000	~0.3
	Cash assistance	~79	~25	~400	~0.1
	Shelter	<i>Funds are used to support transitional housing and other sheltered housing that is not covered under targeted programs</i>			~0.3
	Total spending (\$ billion)				~0.6

Note: HH denotes household. Numbers may not add exactly due to rounding.

¹ Based on expert estimates.

² Temporary Assistance to Needy Families.

Source: Temporary Assistance to Needy Families Web Site; US Interagency Council on Homelessness federal budget appropriations; secondary research; expert interviews; McKinsey analysis

B SSI/food stamps/child welfare program spending on homeless is approximately \$0.9 billion.

	Program	Population	% of population	Monthly spending per user/HH (\$)	Annual spending (\$ billion)
SSI¹	Individuals	407,966	5%	500	0.1
	Families (HH)	79,446	4%	500	0.02
	Total				0.1
Food stamps	Individuals	407,966	90%	90	0.4
	Families (HH)	79,446	90%	200	0.2
	Total				0.6
Child welfare	Families (HH)	79,446	5%	5,000	0.2
	Total SSI¹/food stamps/child welfare				0.9

Note: HH denotes household.
 1 Supplemental Security Income.

Source: Secondary research; expert interviews; McKinsey analysis

Criminal justice technical appendix

This presents the objective, scope, and methodology of our efforts to estimate national government spending on criminal and juvenile justice, as well as the number of constituents who may be candidates for preventive community-based interventions suitable for SIBs.

	Size of government criminal- and juvenile justice spending	Number of constituents
Objective	<ul style="list-style-type: none"> Our estimates are intended to approximate government spending on criminal and juvenile justice at the national, state, and local level 	<ul style="list-style-type: none"> Our estimates are intended to approximate the number of adults incarcerated and juveniles held in residential placement who may be candidates for preventive community-based alternatives to incarceration
Scope	<ul style="list-style-type: none"> Total government spending at the federal, state, and local level We focused on the corrections component of criminal- and juvenile-justice spending, including all correctional and confinement institutions holding prisoners for more than 48 hours, probation activities, parole and pardon boards and programs, and halfway houses 	<ul style="list-style-type: none"> Adult inmates who were incarcerated for drug-related offenses Adult inmates who were incarcerated with mental health or substance abuse disorders Juveniles who were held in residential placement for nonviolent offenses
Methodology	<ul style="list-style-type: none"> We used comprehensive national expenditure data published by the Department of Justice's Bureau of Justice Statistics to determine total government spending on criminal justice <ul style="list-style-type: none"> 2007 is the most recent year from which data are available Spending is broken out for federal, state, and local governments, but few other estimates are available for the entire country We then used 3 different approaches to estimate total government spending on juvenile justice <ul style="list-style-type: none"> Extrapolated absolute cost from results of 2008 national survey on average daily juvenile justice expenditures¹ Determined relative cost based on detailed data from Washington, which stated that it costs ~3 times as much to incarcerate a youth as it does an adult² Updated and broadened state-level data on juvenile justice spending from a comprehensive 1998 survey³ 	<ul style="list-style-type: none"> We identified the number of adult inmates who were either incarcerated for drug-related offenses or had mental health or substance abuse disorders by drawing <ul style="list-style-type: none"> From <i>Behind bars II: Substance abuse and America's prison population</i>, a 2010 report from The National Center on Addiction and Substance Abuse at Columbia University <ul style="list-style-type: none"> 2006 is the most recent year for which data are available We identified the number of juveniles held in residential placement for nonviolent offenses from the Office of Juvenile Justice and Delinquency Prevention's <i>Census of juveniles in residential placement</i> <ul style="list-style-type: none"> 2007 is the most recent year for which data are available

¹ Costs ranged from \$24 in Wyoming to \$726 in Connecticut (2008 American Correctional Association statistics, presented in *The costs of confinement: Why good juvenile justice policies make good fiscal sense*, Justice Policy Institute, May 2009).

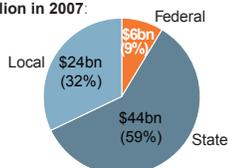
² Steve Aos et al. "Return on investment: Evidence-based options to improve statewide outcomes." *Technical Appendix II Methods and User Manual*, Washington State Institute for Public Policy, July 2011, Exhibit D2.a.

³ National Association of State Budget Officers. *State juvenile justice expenditures and innovations*, 1998 estimate of \$4.2 billion scaled by growth in total (adult and youth) corrections spending from 1998 to 2007, and ratio of total state and local spending to state-only spending.

Source: Bureau of Justice Statistics; Office of Juvenile Justice and Delinquency Prevention; McKinsey analysis

We developed guiding principles for determining government spending on criminal and juvenile justice.

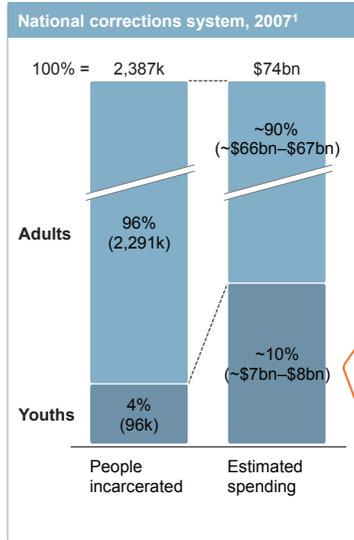
 Details follow

Approach	Government-spending estimates
<ul style="list-style-type: none"> Social impact bonds (SIBs) monetize social outcomes by capturing the value between the cost of prevention now and the price of remediation in the future To understand the pool of government spending (a fraction of which SIBs could potentially address), we focused on the corrections component of criminal- and juvenile justice spending¹ <ul style="list-style-type: none"> Since some constituents are not eligible to receive preventive interventions, only a fraction of this remedial spending is addressable by SIBs Although there are no national statistics, experts believe that only a small share of corrections spending goes to preventive programs (e.g., reentry programs) Other components of criminal justice spending, such as police protection, are less directly tied to remediation Comprehensive national expenditure data are published by the Department of Justice's Bureau of Justice Statistics <ul style="list-style-type: none"> 2007 is the most recent year available, due to the time it takes the US Census Bureau to collect local government-spending data Spending is broken out for federal, state, and local governments, but very few other estimates are available for the entire country We verified our assumptions and the estimates we used with multiple experts in the fields of criminal and juvenile justice 	<ul style="list-style-type: none"> Although only a fraction of this is addressable by SIBs, national corrections spending was \$74 billion in 2007:  We estimate that spending on youths accounted for ~10% of this (\$7bn) Because the cost of incarceration varies substantially with inmate characteristics, it is not possible to reliably estimate remedial spending for specific subpopulations that are potential targets for SIBs at the national level... ...But because these subpopulations are incarcerated by state and local authorities for which more granular cost estimates are often available, this lack of national data is not likely to present a major barrier to the adoption of SIBs for criminal and juvenile justice

¹ Corrections spending includes all correctional and confinement institutions holding prisoners for more than 48 hours, probation activities, parole and pardon boards and programs, and halfway houses.

Source: Bureau of Justice Statistics, "Justice expenditure and employment extracts", expert interviews

Youth corrections spending is approximately \$7 billion to \$8 billion.



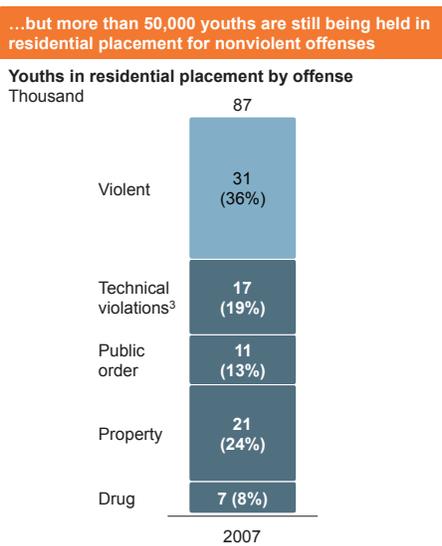
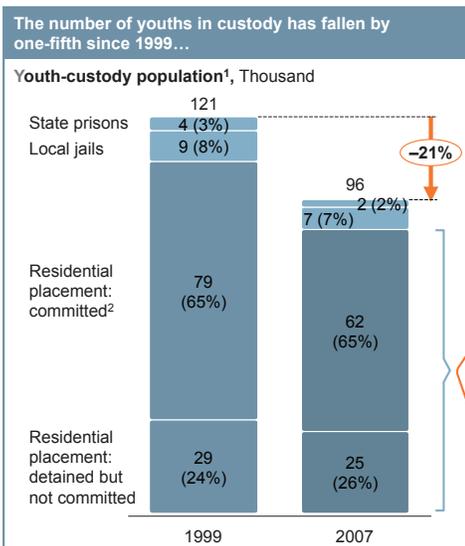
Youth share of corrections spending

In the absence of any comprehensive national data, we used **3 approaches** to estimate that spending on youth corrections was **\$7 billion to \$8 billion in 2007**

- **Absolute cost of youth incarceration: \$7.9 billion**, based on \$241 daily avg. cost of youth incarceration from national survey^{2,3}
 - 87,000 youths in juvenile facilities x \$241 per day x 365 days
 - 9,000 youths in adult facilities at same daily cost as adults
- **Relative cost of youth incarceration: \$7.5 billion**, based on detailed data from Washington that states that it costs ~3 times as much to incarcerate a youth as it does an adult^{3,4}
 - Marginal operating cost of state institution is \$37,000 per youth but only \$13,000 per adult, a multiple of ~3x
 - Youths are only 4% of those incarcerated, but if each costs ~3x more than each adult, then youths will account for ~10% of total national spending
- **Updating and broadening state-level data: \$7.5 billion**, starting with comprehensive 1998 state expenditure survey⁵
 - \$4.2 billion spending by the states in 1998 *multiplied by*
 - 1.7% CAGR⁶ for 9 years (growth rate of total corrections spending over this period) *multiplied by*
 - 1.5 local multiplier (2007 ratio of total state and local corrections spending to states-only spending)

1 Adults: estimated adults aged 18+ in jails and prisons (Bureau of Justice Statistics (BJS), "Correctional populations in the United States," 2010); youths: total juveniles under 21 years held in residential placement facilities (Office of Juvenile Justice and Delinquency Prevention, *Census of juveniles in residential placement, 1997-2010*) plus juveniles under 18 years held in state prisons and local jails (BJS, *Sourcebook of Criminal Justice Statistics*, www.albany.edu/sourcebook).
 2 Costs ranged from \$24 in Wyoming to \$726 in Connecticut (2008 American Correctional Association statistics, presented in *The costs of confinement: Why good juvenile justice policies make good fiscal sense*, Justice Policy Institute, May 2009).
 3 Approach assumes that adult and youth systems spend the same share of their budgets on non-inmate costs (for example, probation activities).
 4 Steve Aos et al. "Return on investment: Evidence-based options to improve statewide outcomes." *Technical Appendix II Methods and User Manual*. Washington State Institute for Public Policy, July 2011, Exhibit D2.a.
 5 National Association of State Budget Officers, *State juvenile justice expenditures and innovations*, 1998 estimate of \$4.2 billion scaled by growth in total (adult and youth) corrections spending from 1998 to 2007, and ratio of total state and local spending to state-only spending.
 6 Compound annual growth rate.
 Source: Bureau of Justice Statistics; Office of Juvenile Justice and Delinquency Prevention; McKinsey analysis

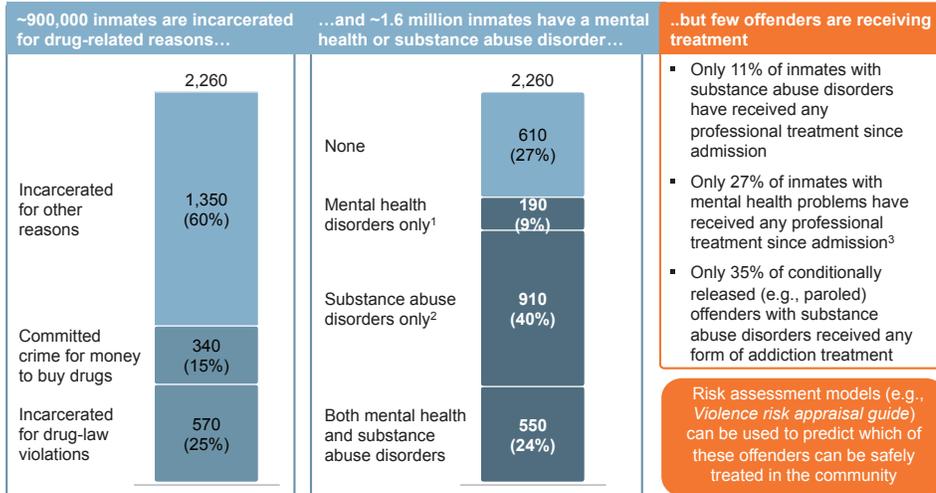
Despite declines in incarceration rates, many more youths could still be offered alternatives to incarceration.



1 Total juveniles under 21 years held in residential-placement facilities plus juveniles under 18 years held in state prisons and local jails.
 2 "Committed" is juvenile equivalent of "convicted". Count includes those in residential placement for diversion and other reasons (fewer than 2,000).
 3 Includes status offenses.
 Source: Office of Juvenile Justice and Delinquency Prevention, *Census of juveniles in residential placement, 1997-2010*;
 Bureau of Justice Statistics, *Sourcebook of Criminal Justice Statistics* (www.albany.edu/sourcebook)

Almost three-quarters of adult inmates have a mental health or substance abuse disorder, but few are receiving treatment.

Thousands of adult inmates, 2006



1 Defined as any past diagnosis of a psychiatric disorder or history of treatment.

2 Defined by medical criteria for drug or alcohol abuse or dependence in year prior to arrest.

3 Bureau of Justice Statistics, *Mental health problems of prison and jail inmates*, September 2006. Mental health problems defined more broadly than mental health disorders, including history or symptoms meeting medical criteria.

Source: The National Center on Addiction and Substance Abuse at Columbia University, *Behind bars II: Substance abuse and America's prison population*, February 2010