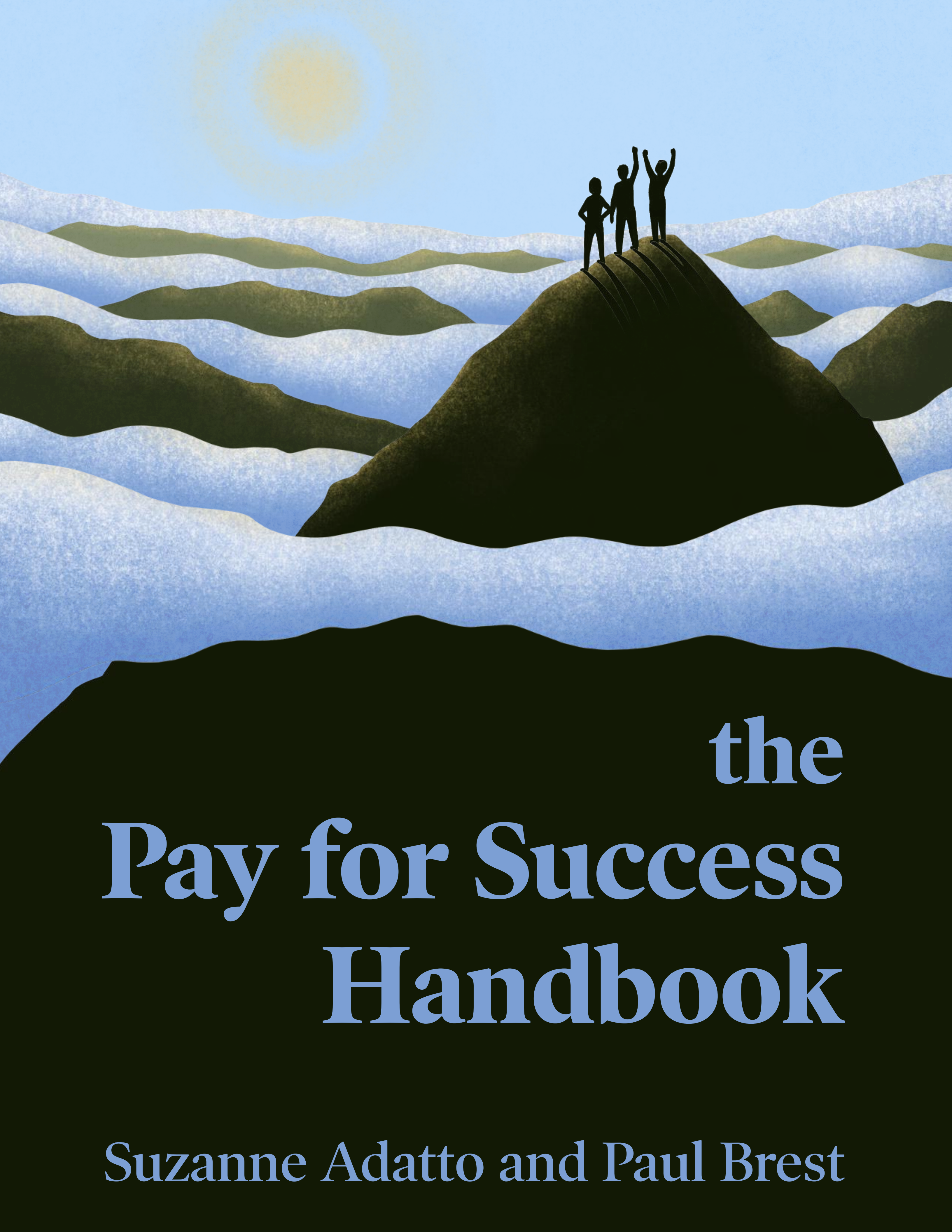

the Pay for Success Handbook

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The Pay for Success Handbook

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CONTENTS

PREFACE AND ACKNOWLEDGMENTS

This handbook is written for government officials considering the adoption of Pay For Success (PFS) programs and for students in public policy and business schools interested in studying outcomes-oriented government contracts for services. It is divided into three main parts. Part One introduces concepts necessary to develop and operate a service delivery program and then surveys some of the issues specific to PFS. Part Two presents two detailed case studies and a number of shorter descriptions of PFS programs. Part Three focuses on the components of PFS programs; it also discusses barriers to their development and ways of overcoming them.

The handbook grew out of a seminar taught at Stanford Law School during the winter quarter of 2015–16, which examined barriers to scaling up PFS programs. Paul Brest co-taught the seminar with Professor Joseph Grundfest. In addition to Suzanne Adatto, the students were Brittany Benjamin, Law School; Isiah Deporto, Law School; Sarah Hirshorn, undergraduate; Maria Garcia Lecuona, International Policy Studies; Austin Lee, Law School; Spike Lipkin, Graduate School of Business; and Lucie Zikova, International Policy Studies.

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Part One: Introduction and Overview

Government agencies frequently contract with nonprofit or for-profit organizations to provide services to improve the well-being of their clients—for example, by reducing recidivism, homelessness, or drug use. Governments have traditionally paid service providers on the basis of the number of clients they treat.

The past decade has seen a number of *Pay for Success* (PFS) or *results-based finance* (RBF) programs, in which service providers are paid for their outcomes or results. For example, whereas a government agency contracting with a service provider to reduce recidivism among young men released from prison would traditionally have paid the service provider for the hours spent counseling a client, a PFS contract pays the organization for success in reducing the clients' rate of recidivism from some baseline.

PFS projects are an important part of a movement focused on

- Improving the *effectiveness* of government agencies and service delivery organizations.
- Achieving *measurable social outcomes* for beneficiaries.
- Demonstrating, using *evidence* based on prior evaluation of that particular program or similar ones, that a program is likely to work.
- *Monitoring and evaluating* a program in real time to ensure that it is on track to achieve its intended outcomes and to make course corrections where it is not.
- *Reducing the silos* of government agencies so that they can better serve common beneficiaries and improving *coordination and collaboration* among stakeholders more generally.
- Undertaking *active contract management* with service providers. This term, coined by Jeffrey Liebman, director of Harvard's Kennedy School's Government Performance Lab, describes combining "high frequency use of data and collaborative meetings between government agencies and service providers to improve outcomes from contracted services."[1]

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1 Harvard Kennedy School Government Performance Lab, *Active Contract Management: How Governments Can Collaborate More Effectively with Social Service Providers to Achieve Better Results*. Retrieved January 30, 2019, from https://govlab.hks.harvard.edu/files/siblab/files/acm_policy_brief.pdf.

This list makes apparent the potential benefits of PFS for state and local governments. PFS can improve the effectiveness of services that are already outsourced to non-governmental organizations, and it may lead to the effective outsourcing of services that are currently provided by governments.

But the design, negotiation, implementation, and assessment of PFS projects are fraught with complexities. Even when governments can adopt an outcome-focused method of delivering services—by no means an easy task—agencies may be entrenched in silos. They may be bound by bureaucratic procedures and mentalities that resist the creativity and flexibility necessary for PFS. Moreover, agencies' budgets are often fragmented. Budget categories may produce mismatches between who pays for a PFS project and whose stakeholders benefit—sometimes called the "wrong pockets" problem.

Although some projects are producing positive results, the overall cost-effectiveness of PFS is less clear when one considers projects that started up but were abandoned or failed. Even those that succeeded may not be practical once one accounts for their full costs: the time devoted by government officials and organizations; the transaction costs, including legal costs, of multi-party negotiation; technical assistance; and philanthropic subsidies to insure against downside risk.

In any event, before committing itself to a PFS project, a government body should ask at least these questions:

- What can PFS accomplish that the government cannot do cost-effectively by other means?
- Are the relevant agencies ready for an outcomes-focused approach to service delivery, and if so, does PFS seem within their reach?
- Is the project premised on a well-defined theory of change supported by reasonably good evidence?
- Will the program provide feedback to make course corrections along the way?
- Will the program contribute to the evidence base of what works—and what doesn't?
- Can the program's payment scheme reduce political and financial risks, and can outside philanthropic or commercial funders help mitigate these risks?
- If the project demonstrates success, is there a plan for continuing or scaling it?

We return to these issues in depth later in this handbook.

In the spring of 2019, the Nonprofit Finance Fund published *Pay for Success: The First 25*,[2] a comprehensive study of US PFS projects to date. We highly recommend it to readers who wish to explore the topic in greater depth.

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[2] https://nff.org/report/pay-success-first-25

ANTECEDENTS: THE OKLAHOMA "MILESTONES" PROGRAM

The concepts embodied in the PFS movement have roots in efforts to improve government efficiency going back at least to the 1960s. They are well captured in David Osborne and Ted Gaebler's 1993 book, *Reinventing Government*. Before turning to the contemporary movement, we will describe Oklahoma's earlier Milestones program, which was designed to improve the cost-effectiveness of placing the state's physically and mentally disabled people in private sector jobs.[3]

Since the Rehabilitation Act of 1973, states have been able to draw on federal funds to support people with severe developmental and mental disabilities. Beginning in 1987, the Community Rehabilitation Services Unit (CRSU) of the Oklahoma Department of Rehabilitative Services began contracting with service providers to place and support such people in jobs in the private sector.

CRSU's providers used job coaches to assess and train their clients and place them in jobs. The coaches would often "shadow" their clients, accompanying them in their jobs, and then "fade" as the clients no longer needed their support. The ultimate goal, which the federal statute called Status 26 ("closed rehabilitated"), was successful attainment of the client's individual vocational goal and employment for 17 weeks plus 60 days (as shown in the table below).

The program started with CRSU paying providers $23/hour for services rendered by job coaches and others. The agency required providers to document their particular services and bill in 15-minute increments. (Billing took 10 percent of providers' employees' work time.) On average, it cost $22,527 and took 438 days to successfully close a client's case. The typical coach worked with five clients per year but did not meet CRSU's minimum requirement of two closures per year. Providers could bill for only 18 months, and they often went to the maximum.

Recognizing the inefficiency of the program, CRSU staff, in consultation with a number of providers, piloted a radically different program, which it then implemented on a large scale. Rather than paying for hours of services provided, CRSU paid providers for the accomplishment of steps or milestones. The total payment was based on a percentage of the average cost of closure (including dropouts). It was negotiated with each provider and varied by the nature of its client population, available job opportunities, its past history, and other factors. The percentage paid increased as more milestones were achieved. The following table shows the milestone payments for developmentally disabled clients:

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3 See Daniel O'Brien & Rebecca Cook. (1997). *Oklahoma Milestone Payment System* (Pioneer Institute). Retrieved January 30, 2019, from http://bgc.pioneerinstitute.org/oklahoma-milestone-payment-system/. Harvard Kennedy School of Government, *Oklahoma's Milestones Reimbursement System: Paying for What You Get* (Case HKS060, 1998); Daniel O'Brien & Grant Revell. (2005). "The Milestone Payment System: Results Based Funding in Vocational Rehabilitation," „*Journal of Vocational Rehabilitation* 23(2), pp. 101-114.

Determine needs	10%
Job placement	15%
Four weeks job retention	15%
Ten weeks job retention	15%
Job stabilization (employed 17 weeks)	20%
“26 closure” (stabilization plus 60 days)	25%

Providers were anxious about the transition, sometimes for good reasons. The new system exposed internal inadequacies in the providers’ systems and staff. Although the vast majority improved, several providers went out of business.

Nevertheless, the positive results of the change were dramatic. Staff members had more flexibility in dealing with the clients’ problems. They could give the clients more personalized attention and generally fade earlier than under the prior system. The providers achieved twice as many closures in much shorter times, with an average cost of $10,813 per closure—half that of the prior system. The administrative costs of compliance and billing plummeted.

Nonetheless, problems remained. The milestones system treated stable work as the sole criterion of success. Although the metric arguably reflected clients’ job satisfaction, some government officials and providers believed that, especially for their most severely disabled clients, it did not capture other important aspects of well-being (e.g., avoiding hospitalization). The contracts were not open-ended, and some successful providers completed their contracts so early that they ran out of paid work.

The milestones system was also vulnerable to the problem of cherry-picking or creaming, especially in highly competitive urban markets. Under the previous pay-for-services model, it was in a provider’s interest to take on very difficult clients, because it could bill almost countless hours for them. Under the milestones system, the provider had to absorb the time spent on clients; it was paid only for achieving program milestones. The new system created an incentive to select the easiest clients—those most likely to meet all the milestones. CRSU responded by building in countermeasures and controls.

A retrospective study of the Oklahoma Milestones program describes five alliterative principles underlying the program:[4]

- *Collaborative planning*. Three main groups of stakeholders were involved in designing the program and planning for its implementation: government agencies, service providers, and

[4] O’Brien & Revell. (2005).

representatives of the clients.[5] One should not underestimate the difficulty of reorienting government officials. Rather than checking providers' compliance with contractual terms, they were expected to help develop and then monitor appropriate milestones. The program's primary architect lamented the difficulty of countering "the resistance of some agency staff to getting out of the office and getting their hands dirty."[6]

- *Customer-centric outcomes*. A primary determinant of stable employment is the client's satisfaction with the job.
- *Creaming countermeasures*. At the outset, reducing creaming requires setting payment rates to account for the risks involved in assisting the most severely disabled clients. The Oklahoma Milestones program used a probability-based system that accounted for specific client risk factors to set rates.
- *Customer control*. The milestones were defined in terms that most clients could understand, and where feasible, clients were given a choice of service providers.
- *Proven Concepts*. The program was based on evidence from other vocational rehabilitation programs, and the milestones were developed and updated in light of data gathered from operating the program.

A retrospective summary of the program notes: "The three most important measures of success are customer satisfaction (both employers and consumers of the services), reduced need for regulation and oversight by the state agency, and increased achievement of the core outcome, that is, successful competitive employment."[7]

Opportunities for customer satisfaction checks come into play at several points in the Milestones process. For instance, if a provider places an individual in a job that he or she does not like or for some other reason does not want, the provider is not approved for payment for that milestone. This motivates the provider to please two major customers, the consumer of the service and his or her Vocational Rehabilitation Counselor, so that payment may be received. As job satisfaction is a major component of success and the provider cannot be paid without achieving it, a major shift of emphasis toward quality as defined by the customer has resulted. For example, goal planning is reinforced by the requirement that the job achieved matches the customer's career goal.

Each milestone definition includes quality outcome indicators to be accomplished before payment. The final two milestones include verification that the consumer and employer are satisfied with

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[5] Apparently, clients themselves were not consulted. Listening to beneficiaries has only recently become a mainstream practice. See Fay Twersky, Phil Buchanan, and Valerie Threlfall, "Listening to Those Who Matter Most–the Beneficiaries," *Stanford Social Innovation Review*. (Spring 2013). Retrieved June 6, 2019, from https://ssir.org/articles/entry/listening_to_those_who_matter_most_the_beneficiaries.

[6] O'Brien & Cook. (1997).

[7] Ibid.

the job placement, training, and support provided. Formal customer satisfaction surveys are required for payment of the final milestone. This creates a quality check by the most qualified evaluators, the recipient of the service and his or her supervisor. This information is submitted to the agency staff overseeing the service. The state agency's counselors are instructed to withhold final payment unless it is confirmed that the consumer of services and employer are satisfied. This has resulted in providers' returning to the job site to correct problems they could have ignored under previous payment structures.

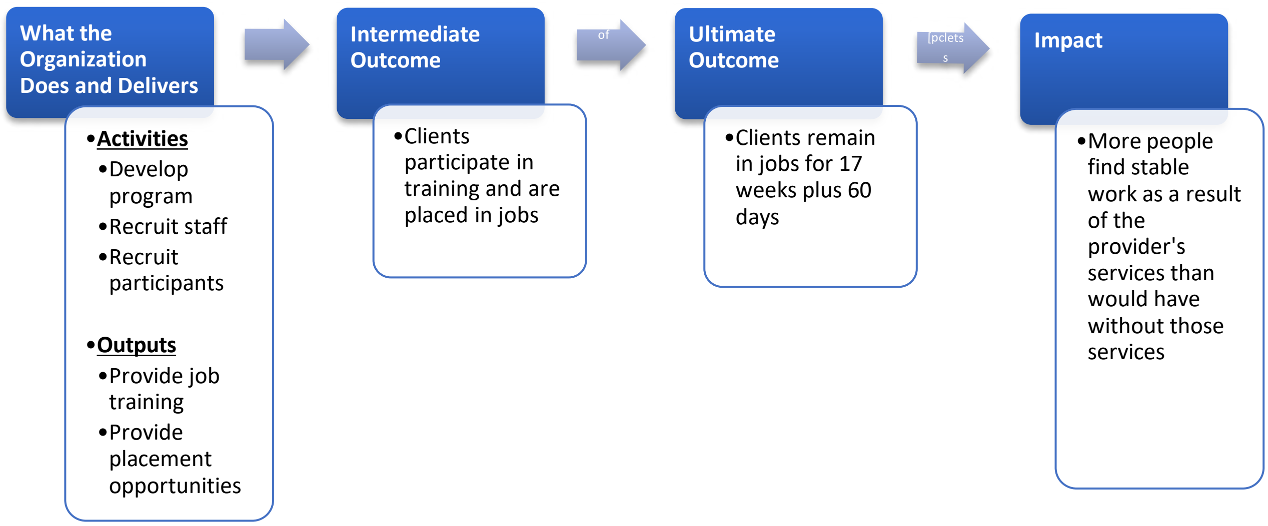
The Community Rehabilitation Services Unit conducted an evaluation of results during August 1997. Data was collected from agency records and supplemented with data gathered from service providers.[4] The data shows that waiting lists are reduced because consumers are now more efficiently and effectively served. The average number of months consumers spent on waiting lists was reduced from 8.14 months under hourly to 3.85 months under Milestones. This reduction represents 53 percent fewer customer months of waiting for the providers who have a waiting list. Consumers who previously had been perpetually "assessed" now move quickly through the Milestones process to employment and independence. The average weeks spent in assessment before job placement dropped 18 percent, from 12.1 weeks to 9.9.

Provider efficiency is improved by reducing the paperwork load required of the direct service provider. When hourly rates are the basis for payment, the process of documenting increments and categories of services provided must be meticulously tracked. Providers previously completed as many as 18,000 data entry screens each month to insure payment for every increment of service time. Now, time formerly devoted to detailed documentation is redirected toward accomplishing the outcome for the consumer. The only information that must be documented by the provider and approved by the counselor is the proof that the outcome was achieved. The change to Milestones has resulted in a 33 percent overall reduction in the work hours required by record keeping. Providers report as much as a 100 percent increase in productivity in terms of consumers placed and stabilized in competitive employment.

One of the best features of the Milestones program is that providers generally like it better and feel that it benefits the consumers they serve. Six months after conversion to Milestones, a survey of direct service staff indicated that 81 percent believe the quality of services under Milestones is better or much better than under hourly.

Introduction to an Outcomes Framework: The Theory of Change for a Service Delivery Program

As background, it is helpful to set out the theory of change, or logic model, that underlies the provision of virtually any social services. Consider the theory of change underlying a job-placement program of the sort supported by the Oklahoma Milestones program.



The *activities* and *outputs* are what the service provider must do and deliver to achieve the *ultimate outcome*. The *intermediate outcome* is a step along the way that typically requires a change in beneficiaries' behaviors—in this case, that clients participate in the program. The *ultimate outcome* is the government's and the service provider's shared goal for the program—here, stable employment, as defined by the federal standard for a "close."

Activities and outputs are what the service provider organization does; outcomes are changes in clients' behavior as a result of what the organization does. To use the familiar cliché, activities and outputs are the equivalent of leading a horse to water; the intermediate outcome is making the horse drink. The ultimate outcome is that the horse is adequately hydrated. The ultimate outcome of the vocational program is that the clients are stably employed.

Ultimate Outcomes vs. Impact

Impact is the difference between the outcome of the program and the outcome had there been no program (or had there been an alternative program). Did the program *cause* the outcome? To arrive at an answer, we consider what would have happened in the absence of the program (the counterfactual). If the outcome would have happened anyway, then the program had no impact.

Why should Oklahoma's CRSU care? Because if the outcome would have happened anyway, the state agency could have avoided the effort and costs of the activities involved.

The Empirical Basis for the Theory of Change

A theory of change is essentially a set of causal links. That each step will lead to the next is an empirical claim. Whether the program's outputs will lead to the intermediate outcome—that is, whether the targeted clients will participate in the program—is relatively easy to predict. But whether the intermediate outcomes will lead to the ultimate outcome of stable employment for CRSU's clients is more difficult to predict. Given the clients' severe disabilities, it seems likely that CRSU's program will have had a positive impact on job placements and retention. As we will see, however, this is hardly typical of social programs. Determining whether a particular program actually has the impact desired is the task of program evaluation.

PAY FOR SUCCESS

As of August 2019 there were twenty-two active PFS projects in the United States and about fifty additional projects in development.[8] Twenty-one jurisdictions have enacted legislation to promote the development of PFS projects.[9] The projects operate on a municipal scale and statewide to deal with a range of social issues, including recidivism, chronic homelessness, prenatal health care, and early childhood education.

PAYMENT UNDER A PFS PROGRAM: ULTIMATE OUTCOMES VS. IMPACT

A PFS contract might stipulate payments based on either ultimate outcomes or impact.

Under an outcome-based payment scheme, the service provider is paid to the extent that its program outcomes exceed an agreed reference point or baseline.

The outcome also must have occurred under an impact-based payment scheme. But in addition, the success rate of the service provider's clients is compared to a group of similar clients who are not in the program, and the service provider is paid to the extent that its success rate is greater. A highly regarded technique for an impact-based evaluation is the randomized controlled trial (RCT), in which potential clients are randomly assigned either to a group eligible to receive the program's treatment or to a control grou[10]

The main advantage of an outcome-based payment scheme is that it is simple and inexpensive to implement—largely because it does not require an evaluation to determine impact. An outcome-based scheme permits the government to publish *rate cards*, a payment mechanism wherein a government specifies how much it is willing to pay for particular outcomes. Multiple service providers can serve similar populations and be paid on a per-outcome basis, without complicated individual negotiations with the government. Another advantage, discussed in the next section, is that it allows the service provider to get paid sooner than under an impact-based scheme.

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8 https://www.payforsuccess.org/projects/?facets%5B0%5D=current_phase%3A575&sort=recent

9 Id.

10 See page 59.

The main disadvantage of an outcome-based payment scheme is that, in the absence of evaluation, the parties cannot know whether and to what extent the program is actually making a difference. And without at least occasional evaluations of programs addressing the issue, the field does not gain knowledge of what works and does not work.

The Service Provider's Risks and Its Challenge of Obtaining Working Capital Under PFS

The Inherent Risk in the Service Provider's Calculation of Costs and Revenues

A service provider that is paid for the number of clients counseled can predict its costs and its revenues from a government contract with considerable accuracy and can negotiate the terms of the contract accordingly. A service provider paid for outcomes—especially when outcomes are defined by a demonstration of impact—must treat a number of clients for each one who actually achieves the agreed outcome. The uncertainty surrounding this number can be reduced if there is good data about the outcomes of a program. This is the case if the program has run for a considerable time. Even then, changes in the external environment could have a significant effect on the success rate—for example, a region's macroeconomic conditions will influence the success of a job placement program—with particular risks to small programs.

Therefore when payment is based on outcomes or impact, the service provider assumes a considerable risk that the services provided will not result in the agreed outcome or impact. The risk can be mitigated by increasing the payment for each successful outcome, or by setting a lower bar for success (for example, reducing the proportion of those treated who must succeed or reducing the length of the period of job stability that counts as success), or providing base payments for services rendered and a bonus for successful outcomes.

The Service Provider's Need for Working Capital

Under a conventional pay-for-services arrangement, a service provider can bill the government for providing services weekly or monthly. Under a PFS contract, in contrast, the service provider must await a determination that it has achieved the agreed outcome or, even more demanding, that the service provider *caused*, or *contributed to*,[11] the outcome. Under Oklahoma's Milestones jobs

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[11] Impact implies causation. It is the difference between the actual effect of an activity in achieving the intended outcome and what would have happened if the activity had not occurred. It is seldom possible to attribute a result to a single activity. To say that a service provider's work "contributes" to an outcome means that, although the investment may not be the sole cause of the outcome, the outcome would not have occurred, at least not to the same extent, without its activities.

program, one may not be able to measure meaningful outcomes for several months, and proof of causation will further increase the delay.

Many potential service providers lack the reserves to absorb the costs of operating a program for a year (or more). Few would be able to get a bank loan or line of credit, especially given the risk of the organization's failure to achieve the outcome that triggers payment.

PFS programs have attempted to solve this problem in two ways:

- External investors may front the service provider's operating funds and get repaid by the government to the extent that the program succeeds. In many PFS programs to date, philanthropic investors have made below-market-rate loans, and commercial investors have lent at minimal market rates—sometimes backstopped by philanthropies. Although having investors front the money reduces the risk both to the government agency and to the service provider, recruiting investors to a PFS program and negotiating terms with them tend to incur high transaction costs.
- The government may pay partial compensation for services and reserve the remainder—called deferred compensation or a bonus—for outcomes or impact.

Data Challenges for PFS

In order to predict whether a service provider's program is likely to work, one must evaluate prior similar programs and predict whether the conditions that led to their putative successes are likely to be applicable in this situation as well. This is the question of *generalizability*, which we discuss further below.

As the program is implemented, it also requires data collection and analysis (1) by the service provider, who must track activities and outputs for internal management purposes; and (2) by all parties who must track outcomes or impact. The first of these should be routine for most organizations. Ideally, the second should be as well. But (as discussed immediately below), it is not—either for most service providers or for many contracting government agencies. Moreover, in both cases, the data may be dispersed among various sources and be difficult to gather in one place because of a lack of interoperability, privacy regulations, or administrative inertia.

Organizational Challenges for PFS

The structure and modus operandi of both governments and service providers, as well as the mindsets of their staff, present challenges for PFS contracts. Many, perhaps most, government agencies are unfamiliar with outcomes-oriented payments for service delivery. Contract compliance tends to be focused on activities and outputs to the exclusion of outcomes and impact. As Burt Perrin at the World Bank writes,

> Implementing an outcome focus represents a fundamental shift in the nature of thinking, acting, and managing within the public sector, away from a focus on process and on what one needs to do, to a focus on benefits. This in turn has implications for many other aspects of management—for example, for existing accountability and reward mechanisms, as well as the manner in which government relates to its citizens.[12]

A further organizational problem involves government budgets for financing PFS programs. As difficult as it is to combine data from various agencies, it is even more challenging to get them to chip in to pay for a PFS program. For this reason, the ultimate payments for such programs often come from a special budget allocation.

Feasibility studies for PFS projects have sometimes brought these issues to the fore. For leaders of potential projects funded through the California PFS Initiative,[13] this exploratory phase illuminated the need for enhanced data collection and evaluation systems. It also influenced the collection of outcomes-related data. For example, when the City and County of San Francisco considered reducing homelessness through a PFS model, it understood that it first needed to strengthen its capacity to track the baseline outcomes of those who use their services.[14]

THE COMPLEXITIES OF THE PFS PROCESS AND THE NEED FOR EXTERNAL SUPPORT

For all of these reasons, the process culminating in a PFS program has generally been complex and lengthy. Each contract must thread the needle between various parties, each with its own set of goals and incentives. So far, these arrangements have been bespoke; each required individual crafting. Other potential barriers to the adoption of PFS programs include

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[12] Perrin (2006, p. 7) in Marie-Louise Bemelmans-Videc, Jeremy Lonsdale, & Burt Perrin, editors. (2007). *Making Accountability Work – Dilemmas for Evaluation and f or Audi*t (Transaction Publishers, p. 143).

[13] The California PFS Initiative was launched by the Nonprofit Finance Fund and the James Irvine Foundation in 2014. The initiative is a US$6.6 million effort to provide funding and expert support to help nonprofits and governments to structure Pay For Success programs in California. *Pay For Success blog*. Nonprofit Finance Fund. California Pay For Success Initiative. Retrieved January 28, 2019, from https://payforsuccess.org/opportunity/california-pay-success-initiative.

[14] A. Chan & K. Bailey. (2016). Pay for Success Feasibility Studies: Catalytic Investments, Moving the Needle. *Pay For Success blog,* Nonprofit Finance Fund. Retrieved February 5, 2019, from http://www.payforsuccess.org/blog/pay-success-feasibility-studies-catalytic-investments-moving-needle.

- Assembling the evidence to predict whether a program will succeed—evidence necessary to satisfy governments, service providers, funders, and other stakeholders.
- Identifying sufficiently reliably measurable success indicators to satisfy these parties.
- Negotiating agreements among investors to provide the capital necessary to finance a program, and agreements between those investors and the other parties.

Few state and local governments have the ability to explore the possibilities for a PFS program, conduct due diligence, broker an agreement among the parties, and raise external funding. To fill these needs, a handful of intermediaries have developed the expertise to counsel and represent government agencies in these processes and assume some of the workload. These include, in the United States, Social Finance US, Third Sector, Harvard Government Performance Lab, Nonprofit Finance Fund, and Sorenson Impact Center, and, in the developing world, Instiglio.[15]

Among other things, these intermediaries help governments identify evaluations of prior similar programs in order to assess the likelihood that a program they adopt will succeed. They also help retain program evaluators once it is launched. Evaluation enters a PFS program at several possible points:

- *Before the program is adopted*—to predict the program's effectiveness. To launch a program, all parties need a certain degree of confidence that it is likely to achieve the agreed outcomes.
- *During the program*—to determine payments based on whether the program actually improved outcomes for the target population. This sort of evaluation may be unnecessary, or at least less important, when payment is based on rate cards or other specified outcomes.
- *After the program has been implemented*—to evaluate its success and inform parties whether the program should be replicated, scaled, modified, or abandoned.

[15] See page 71.

Part Two: Case Studies of PFS Projects

In Part Two we examine two PFS contracts in detail and then describe a number of others to give readers a sense of the scope of this developing field. The first contract concerns recidivism and unemployment among male ex-offenders in New York State and illustrates the specification of outcome payments in a PFS program. The second contract covers vulnerable families in Cuyahoga County, Ohio, and illustrates the intra- and inter-organizational dynamics involved in a PFS program.

New York State's PFS Contract for Increasing Employment and Improving Public Safety

PFS contracts have been popular for preventing recidivism. A recidivism-prevention program lends itself to quantifiable outcomes, is easily evaluated, and can create cost savings as well as social benefits.

Rates of recidivism are high throughout New York State. In 2013, New York released nearly 24,000 inmates; historical data predicts that 41 percent of them will return to prison within the following three years. The annual state cost per prisoner in New York is about $60,000 per year.[16] Reducing the rate of recidivism would not only reduce the direct costs of housing a prisoner, but increase public safety, improve the lives of the ex-offenders themselves and their families, and increase the number of productive members of society.

In 2012, New York Governor Andrew Cuomo decided to explore a PFS program to reduce recidivism. The Harvard Kennedy School Government Performance Lab assigned a full-time PFS fellow to New York State to help develop the project and issue a *request for proposal* (RFP) for an intermediary to facilitate the project. The state retained Social Finance as the intermediary to raise capital, identify a service provider, and provide ongoing advising after the project launch. After the RFP process, the state selected the Center for Employment Opportunity (CEO) as the service provider.

The Center for Employment Opportunity (CEO)

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[16] Center for Employment Opportunities website. ("About" section, 2011). Retrieved July 28, 2017, from https://ceoworks.org/about/.

CEO is a non-profit organization that developed a recidivism-prevention program based on the theory that to avoid reoffending, ex-offenders must develop attachment to and engagement with their home community, and they must become employed soon after release. To these ends, CEO provides intensive life skills training and placement in a subsidized part-time job immediately after release, followed by placement in a full-time unsubsidized job and support for job retention for one year thereafter. CEO's model had been developed over 30 years and successfully replicated in fifteen locations throughout the United States.[17]

CEO was an attractive service provider for the State of New York because of its strong track record of evidence-based interventions for ex-offenders and its demonstrated ability to implement the program on a large scale. In 2004, CEO participated in a randomized controlled trial conducted by the nonprofit policy research organization MDRC to measure the efficacy of its program. The results, released in 2012, demonstrated significant decreases in rates of recidivism.[18] CEO's model showed particular impact on the ex-offenders who were deemed most likely to return to prison.[19]

Over the course of its existence, CEO invested heavily in its operating capacity—in performance and data management systems, in personnel, and in creating a culture where data drives improvement. Grants from the Robin Hood Foundation and the Edna McConnell Clark Foundation had allowed CEO to improve its capacity to monitor the impact of its services.[20] CEO also had a pre-existing relationship with the New York State Department of Corrections and Community Supervision (DOCCS), including an ongoing contract to provide job training and other workforce

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[17] Center for Employment Opportunities website. ("About" section, 2011). Retrieved July 28, 2017, from https://ceoworks.org/about/.

Center for Employment Opportunities. ("Our Offices" section, 2013). Retrieved July 28, 2017, from https://ceoworks.org/our-offices/.

[18] We describe the methodology of RCTs in a later section. An RCT conducted by MDRC found that "CEO's program reduced recidivism by between 9 and 12 percent among all participants and by between 16 and 22 percent among those 'recently released' or those who enrolled within three months after release from prison. The MDRC study also showed that CEO reduced days incarcerated by 30 percent for a high risk sub-population, or those individuals at high risk of recidivism." State of New York, Center for Employment Opportunities, & Social Finance. (2014).

[19] Cindy Redcross, Megan Millenky, Timothy Rudd, & Valerie Levshin. (2012). "More than a Job: Final Results from the Evaluation of the Center for Employment Opportunities (CEO) Transitional Jobs Program," *SSRN Electronic Journal* (January). Retrieved February 5, 2019, from https://doi.org/10.2139/ssrn.2010208; and Roca website. Retrieved April 21, 2017, from http://rocainc.org/work/pay-for-success/.

[20] D. Archer-Rosenthal & A. Epps. (July 20, 2015). Voices from PFS Pioneers: CEO— Part 1 [Blog post]. Retrieved April 6, 2017, fromhttp://www.payforsuccess.org/blog/voices-pfs-pioneers-ceo-part-1.

development services.[21] CEO's history of replicating its success in a variety of locations gave the parties some confidence that it would succeed in additional cities.

The Pay for Success Project

Together with Social Finance and other project partners, CEO developed a strategy to serve 2,000 previously incarcerated men in Rochester and New York City between 2014 and 2018. The project had two three-year phases, each serving a cohort of one thousand men for three years. The US Department of Labor (DOL) committed to performance-based payments for Phase I, and New York State agreed to pay for Phase II.[22]

Under the agreement, DOCCS identifies eligible ex-offenders in the two cities and then randomly assigns them to a treatment or a control group. Participants in CEO's program began with five days of life skills training, followed by placement in subsidized transitional jobs—all the while regularly meeting with CEO staff members who provide interview coaching, resume writing, and other job training. Participants who are job-ready are then connected with businesses willing to hire CEO graduates. During the job placement, CEO participants continue to meet with CEO retention specialists, who provide workplace counseling and crisis management, as well as longer-term career planning. CEO also offers "Rapid Rewards," monthly bonuses to its participants for meeting employment milestones and other successes.

The program was designed to avoid perverse incentives and the risk of gaming the system—a service provider's meeting the payout criteria without actually achieving the desired outcomes. One obvious way to game a PFS contract is to select easy-to-treat participants. Under this contract, however, DOCCS uses its own measures of ex-offenders' risk of relapse to select participants. The men are randomly assigned to the treatment or control group, thus avoiding the possibility that CEO could cherry-pick the participants who were the most likely to succeed.

By December 2013, the State of New York, the New York Department of Labor, the State Attorney General, the Comptroller, the DOCCS, the US Department of Labor, CEO, and Social Finance had entered into a PFS contract. Success payments under the agreement are triggered by an evaluation—a randomized controlled trial (RCT) carried out by DOCCS's Division of Program

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21 D. Archer-Rosenthal & A. Epps. (July 22, 2015). Voices from PFS Pioneers: CEO— Part 2 [Blog post]. Retrieved April 6, 2017, from http://www.payforsuccess.org/blog/voices-pfs-pioneers-ceo-part-2.

22 The US DOL agreed to provide success payments for approximately the first three years of the CEO program, with the second phase funded out of an authorization from New York's Executive Budget. New York State Division of the Budget, *2013-14 Executive Budget* (2013). Retrieved February 10, 2019, from https://www.budget.ny.gov/pubs/archive/fy1314archive/eBudget1314/fy1314littlebook/BriefingBook.pdf.

Planning, Research, and Evaluation and by New York State Department of Labor Division of Research and Statistics, verified by an external organization, Chesapeake Research Associates.[23]

Financing

Because the success payments were to be based on comparing CEO's outcomes with those of a control group, it would likely take several years to determine what, if any, success payments were due. To provide working capital in the interim, Social Finance recruited funding from Bank of America Merrill Lynch, which in turn recruited more than forty individual and institutional investors. In addition, the Robin Hood Foundation invested $300,000 in the project and the Laura and John Arnold Foundation $4 million.[24] To make the investment more attractive to the private investors, the Rockefeller Foundation committed to a 10 percent first-loss guarantee for the project—that is, an agreement to indemnify the investors for 10 percent of the loss of capital invested in the project.[25] If the program reached or exceeded specified goals, the DOL and State of New York, for the first and second phases respectively, would pay the investors back the principal, plus interest based on the program's success.

Metrics and Payments

The stakeholders agreed on a set of metrics and associated performance-based payments based on three outcome objectives:

- *Reduction of recidivism*—the average reduction in the number of "bed days" for treatment group participants compared to the control group. This metric mainly reflects the state's costs of incarcerating a prisoner. Payments are based on the costs avoided of an additional day of incarceration. An average reduction of 36.8 prison days during the time periods of the contract would trigger payment of $85 per day in Phase I and $90.10 in Phase II.
- *Engagement in transitional jobs*—the number of treatment group participants who start a CEO transitional job. The number of treatment group members who start a CEO transitional job will trigger success payments of $3,120 per participant in Phase I and $3,307 in Phase II.
- *Employment*—a binary metric based on positive earnings in the fourth quarter after release from prison. This reflects the program's impact after the transitional job; it uses data from New York State's own Department of Labor that captures quarterly unemployment insurance wage data. Payments are based on greater anticipated tax revenue and reduced

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[23] In addition to these parties, Jones Day provided legal counsel, and the Harvard Government Performance Lab is providing additional technical assistance to the State of New York.

[24] LJAF will redirect any returns from this investment toward future social innovation project financing, particularly for program evaluation and scaling.

[25] State of New York, Center for Employment Opportunities, & Social Finance. (2014).

public assistance, determined by the percentage difference between the treatment and control groups. An increase of 5 percent would trigger a payment of $6,000 per person in Phase I and $6,360 per person in Phase II.[26] See Table 1 below.

Outcome Measure	Price Per Outcome	Public Sector Savings and Benefits
Recidivism	Phase I: $85 per day Phase II: $90.1 per day	Average Reduction in 5-Year Bed Days * Price Per Outcome * Number of Participants
Transitional Jobs	Phase I: $3,120 per person Phase II: $3,307 per person	If average hours worked is greater than or equal to 111 hours: Number of Participants Engaged in Transitional Jobs * Price Per Outcome
	Phase I: $20 per hour Phase II: $21.2 per hour	If average hours worked is less than 111 hours: Number of PFS Participants Engaged in Transitional Jobs *Average Hours Worked * Hourly Price Per Outcome
Employment	Phase I: $6,000 per person Phase II: $6,360 per person	Percentage Point Difference in Employment Rates * Price Per Outcome * Number of Participants (capped at $2,000,000)

Table 1. Public sector savings and benefits.[27]

If CEO reaches these goals, the private investors receive returns as high as 12.5 percent on the capital they invested. If the payoff thresholds are not met, the investors lose all but 10 percent of the capital invested.[28]

26 Id.

27 State of New York, Center for Employment Opportunities, & Social Finance. (2014).

28 S. Schaeffer, "Assessing Nonprofit Risk in PFS Deals," *Stanford Social Innovation Review.* (2014). Retrieved February 11, 2019, from https://ssir.org/articles/entry/assessing_nonprofit_risk_in_pfs_deals.

THE PROGRAM'S STRUCTURE AND TIMELINE FOR ITS DEVELOPMENT

Figure 1 illustrates the relationship among the parties to the PFS contract. At the center of the organization chart lies Social Finance NYS Workforce-Re-Entry 2013 LLC,[29] a special purpose vehicle to manage implementation of the project, including the transfer of funds among the parties.

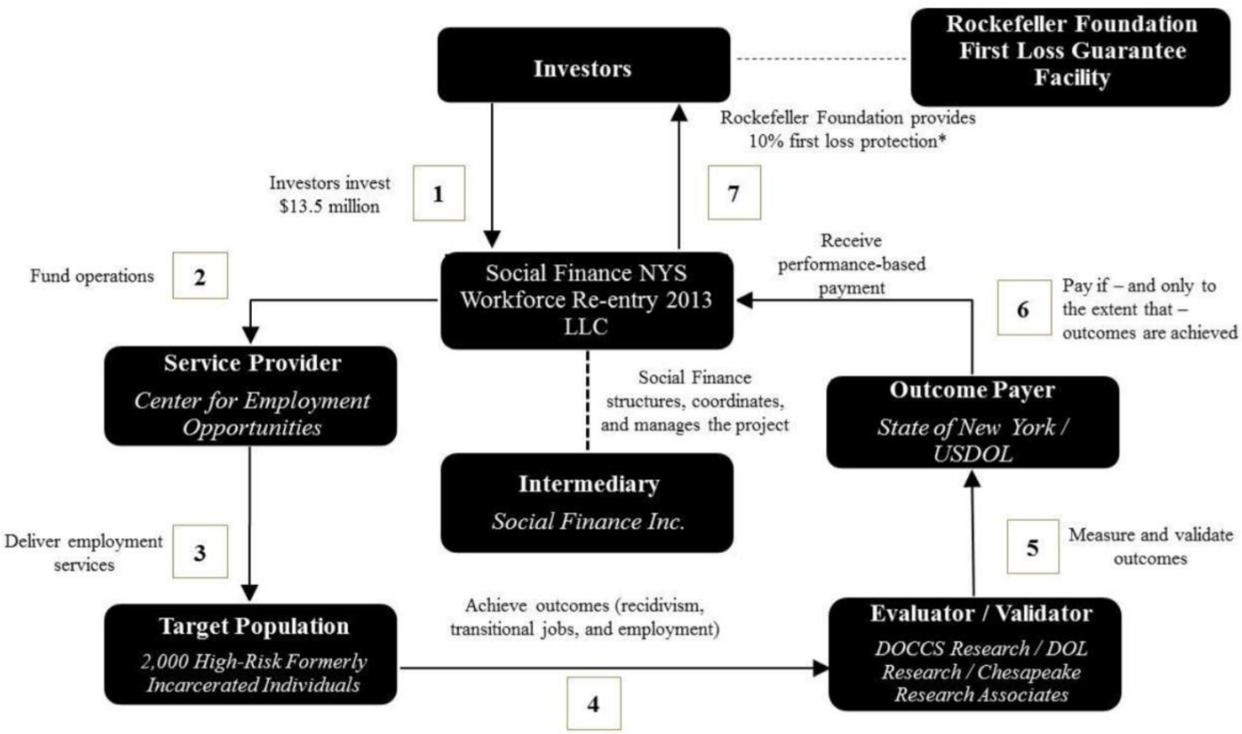

Figure 1. CEO Pay For Success stakeholder model.[30]

Figure 2 shows the timelines leading up to the PFS contract. It illustrates the bespoke nature of most PFS programs to date and indicates the significant transaction costs involved—matters that we shall return to in Part Three of this book.

[29] Bloomberg, Company Overview of Social Finance NY State Workforce Re-Entry 2013 LLC. Retrieved February 13, 2019, from https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=253809042.

[30] State of New York, Center for Employment Opportunities, & Social Finance. (2014).

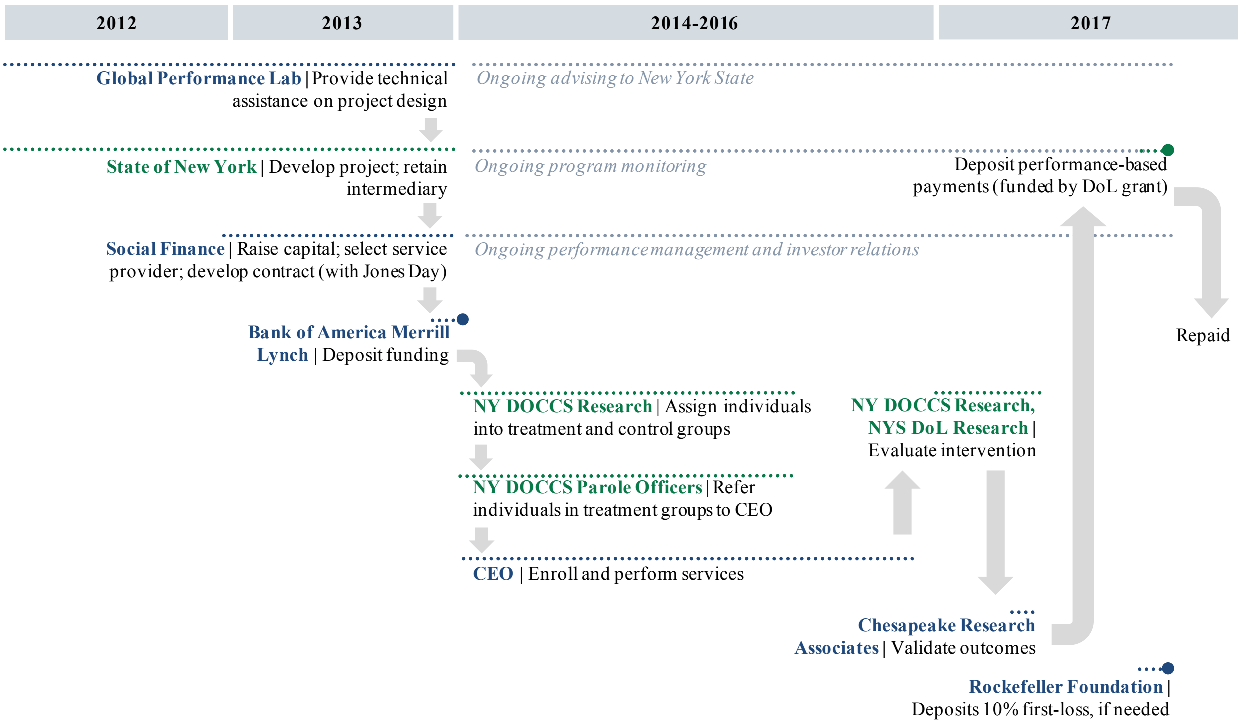

Figure 2. CEO Pay For Success stakeholder relationships and Phase 1 timeline. Adapted from State of New York et al., 2014.

Results to Date, and What Happens Next

The first phase of the contract concluded in 2019. An evaluation by the New York State Division of Criminal Justice Services (DCJS) found:[31]

- *Medium-Term Employment Impacts*: 12 months post-enrollment, CEO participants were 52% more likely to be employed than their counterparts in the comparison group.
- *Long-Term Employment Impacts*: Three years post-enrollment, CEO participants were 48% more likely to be employed than the comparison group.
- *Persistent Recidivism Impacts in NYC*: CEO-NYC participants were 19% less likely to be re-convicted or re-arrested for a felony 3 years post-enrollment.

Meanwhile, the contract has changed the relationship between the government and the service provider in some fundamental ways. Previously, it was CEO's responsibility to recruit participants for its employment program. Under the PFS program, DOCCS evaluates and refers ex-offenders

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31 CEO, *Improving Long-Term Employment Outcomes: Promising Findings from New York State* (February 2019). Retrieved November 7, 2019, from https://ceoworks.org/assets/downloads/CEO-Improving-Long-Term-Employment_022219_v3.pdf

who are deemed high-risk. DOCCS Parole Officers collaborate with CEO staff to encourage offenders to engage with CEO and to meet the conditions of parole. DOCCS has created an internal governance structure to manage the project. DOCCS and CEO have a shared commitment to reach the high-risk men who are likely to benefit most from CEO's services.[32] The government's role has shifted from being a consumer of services to a partner in achieving outcomes.

What happens after the PFS program is completed? In the development of this project there was no formal understanding of what would happen after a successful, or unsuccessful, outcome. The Department of Labor grant was likely one-time only, to test the concept. Although New York State has made no commitments, some stakeholders hope that, if it proves successful, it will lead to a continued relationship between CEO and the state.[33]

(See the Appendix for other examples of PFS programs addressing recidivism.)

Cuyahoga County's Partnering for Family Success Program

In December 2014, Cuyahoga County, Ohio, which encompasses the Greater Cleveland Area, launched a PFS program to reduce the length of stay in out-of-home foster care placements (OHP) for children whose families are homeless or experiencing housing instability.[34]

The idea of a PFS project was brought to the County Executive by the Cleveland-based George Gund Foundation[35] in 2011. The county understood that its agencies' common clients were not being effectively served through disconnected services and systems. Children from families experiencing housing insecurity spend 40 percent longer in the foster care system than their peers.

The PFS program's goal was to help families reunify so that their children would spend less time in foster care. The County Executive included PFS as part of a broader plan to reshape Cuyahoga County's delivery of services. As one county administrator remarked in retrospect, "the creation of the … program enabled us to be truly outcomes focused, collaborative with funders and service providers on initiative design, and risk tolerant."[36]

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[33] D. Archer-Rosenthal & A. Epps (July 24, 2015). Voices from PFS Pioneers: CEO - Part 3 [Blog post]. Retrieved April 17, 2017, from http://www.payforsuccess.org/blog/voices-pfs-pioneers-ceo-part-3.

[34] The following description draws heavily on Third Sector, *Cuyahoga Partnering for Family Success Program: Partner Perspectives and Lessons Learned Report* (interim report February 4, 2016).

[35] Marcia Egbert, Senior Program Officer at the George Gund Foundation, proposed the idea of the PFS project to the Cuyahoga County Executive and played a leading role in guiding approval of the PFS contract and the county legislation establishing a fund to make success payments. As a funder herself, Ms. Egbert gained the support of the project's other two local funders, the Cleveland Foundation and the Sisters of Charity Foundation of Cleveland.

[36] Enterprise Community Partners & Third Sector Capital Partners. (2016). *Developing the Cuyahoga Partnering for Family Success Program: Partner Perspectives and Lessons Learned.* Retrieved February 12, 2019, from

During the three years that followed, proponents explored the idea of a PFS program with government and community partners, local and national funders, and investors. They helped prepare necessary legislation relating to the county budget process, procurement, contracting, and data sharing. In particular,

- The County Council, the county's legislative branch, approved the PFS project and committed funds to it.
- The Office of the Cuyahoga County Executive initiated and continued the PFS project under the leadership of the County Executive.
- The Division of Children and Families, which is responsible for the well-being of children in the program, contributed subject-matter expertise about the population being served and guidance on agency processes. It also provided data needed for identifying the beneficiary population.
- The City of Cleveland-Cuyahoga County Office of Homeless Services, which coordinates the county's efforts to reduce homelessness, provided access to the local homeless management information system and expertise in supportive housing models for populations at risk for homelessness.[37]

During the planning phase of the PFS project, the County Executive Office involved the County Law Department, Fiscal Office (Office of Budget and Management as well as Controller's Office), Sheriff's Office, Division of Children and Family Services, Office of Homeless Services, and Cuyahoga County Council. The planning process required 10–20 percent of the time of one staff member, who otherwise worked on procurement, contracts, and human services. In the contract development phase, his time allocation increased to 50 percent.[38]

The participants relied on Case Western Reserve University's existing ChildHood Integrated Longitudinal Data System (CHILD). This system, created in 1999, connects data from 18 sources and stores more than 500,000 records of children who have lived in Cuyahoga County. CHILD helped project designers identify the beneficiary population, quantify the children's duration in foster care, and design an intervention that met the specific needs of the children and parents.[39] With this data, the planners could move forward to design the program and engage stakeholders.

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http://www.thirdsectorcap.org/wp-content/uploads/2016/02/Final-Cuyahoga-Partnering-for-Family-Success-Program-Lessons-Learned-Report.pdf.

37 Enterprise Community Partners & Third Sector Capital Partners. (2016).

38 Id.

39 P. Auspos. (2017). *Integrated Data Are Key to "Pay for Success".* Baltimore, MD. Retrieved November 7, 2019 from http://www.aecf.org/m/resourcedoc/aecf-integrateddataarekeytopayforsuccess-2017.pdf.

In 2012, with the Gund Foundation's support, the county formally engaged Third Sector to undertake a feasibility analysis of social issues that might be amenable to a PFS model. During the fall of 2012, the county issued a formal Request for Responses (RFR) and launched a competitive process for selecting social service providers, evaluators, and other project partners. The county was seeking responses that addressed a well-defined problem of adolescent behavioral health and child welfare, targeted a specific population, used evidence-based interventions with measurable outcomes, and achieved cost savings for the county and a potential return for funders. The process took fifteen months from the RFR to selection. The county also partnered with staff from local foundations, who helped score proposals and select projects for further review.[40]

Between the winter of 2013 and the following summer, the county selected its service provider: FrontLine Service, a community-based mental health provider for homeless individuals and families. FrontLine collaborates with housing providers to help homeless families settle in housing and stabilize their home environments. It had decades of experience operating in Cuyahoga County, and it offered evidence-based practices that dealt with trauma, child welfare, substance abuse, and homelessness.[41] FrontLine's costs were paid up front, quarterly, from 2015 to 2018, according to a predetermined service budget for the duration of the program.

The county also selected the Center on Urban Poverty and Community Development (Poverty Center) at Case Western Reserve as the lead evaluator and Enterprise Community Partners, Inc., as the project manager, fiscal agent, and manager of a special purpose vehicle to handle the project's fiscal transactions. The Poverty Center had a longstanding relationship with Cuyahoga County and its Division of Children and Families; it had partnered with the division over the past fifteen years to create an integrated data system that connected administrative data from sixteen government systems.

The Poverty Center and project partners also created the main PFS outcome metric: the percentage reduction in out-of-home placement (OHP) days for children of the targeted families (compared to that for children of families in the control group).[42] And the Poverty Center designed an RCT with a total of 270 families or caregivers, with equal numbers in the control and treatment groups.

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[40] As we mentioned above, the George Gund Foundation had initiated the idea of the PFS program. The foundation also played a guiding role throughout the process leading to its launch. The Cleveland Foundation and the Sisters of Charity Foundation of Cleveland had long-term interests in improving social service systems in Cuyahoga County. They, as well as Gund, contributed expertise in social issues related to homelessness and child welfare.

[41] County Commissioners Association of Ohio; FrontLine Service; Jack, Joseph, and Morton Mandel School of Applied Social Sciences; C.W.R.U.; & Third Sector Capital Partners. (2014). *The Case for Pay for Success in Cuyahoga County.* Retrieved February 10, 2019, from http://www.ccao.org/userfiles/140625_Cuyahoga PfS_v4.pdf.

[42] County Council of Cuyahoga County, Ohio (2014). Ordinance No. O2014-0018. Retrieved February 11, 2019, from http://council.cuyahogacounty.us/pdf_council/en-US/Legislation/Ordinances/2014/O2014-0018.pdf.

The County Council established a $5 million Social Impact Financing Fund to develop PFS financing.[43] During the spring and summer of 2014, the County's Division of Children and Family Services (DCFS) worked with FrontLine to develop a program that would take into account the unique needs of the child welfare population. At the time, FrontLine provided case management for housing-insecure families who used DCFS services, but its programming did not measure child welfare outcomes. FrontLine also needed to modify its existing interventions to achieve the PFS goal of reducing out-of-home placement days while continuing to support housing stability and mental health.[44]

Subsequently, a full-time PFS Coordinator with expertise in child welfare and homelessness joined the county team to help design the intervention, program operations, and enrollment referral processes. The coordinator is an ongoing point of contact for DCFS and stakeholders, and it reviews eligibility from referral partners. Meanwhile, local housing providers agreed to collaborate with the PFS program: Cuyahoga Metropolitan Housing Authority, Famicos Foundation, and Emerald Development and Economic Network (EDEN), all housing providers for low-income families, agreed to provide priority admissions to public housing and housing vouchers for PFS families.[45]

Unlike CEO in the preceding example, FrontLine did not have experience with the particular intervention or desired outcomes of the PFS project. A ramp-up period was essential. FrontLine used July through October 2014 to test elements of the program, hire and train staff, and develop other operations before the official project launch, when the agency would be on the clock under the PFS contract. Doing so ultimately reduced the time between a person's enrollment in the program and approval of his or her housing application by half. Activities during this period were largely funded by a grant from the Laura and John Arnold Foundation (LJAF).

FrontLine and DCFS case workers learned how to work together to achieve their new, integrated PFS goals. FrontLine also worked with Cuyahoga Metropolitan Housing Authority and other agencies that would provide housing to the majority of PFS clients.[46]

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43 Id.

44 Enterprise Community Partners & Third Sector Capital Partners. (2016).

45 Id.

46 The ramp-up period allowed DCFS to practice selecting potential families, coordinate the randomization process with the Poverty Center, and educate its staff about the needs of the PFS project. A lesson learned in developing the Cuyahoga County PFS is that an evaluation contract should allow for flexibility in making modifications to the sample and evaluation design. Soon after randomization started, a review of individual DCFS cases revealed that the initial criteria to determine simultaneous housing instability and entry into foster care were too narrow. With the consent of various stakeholders, the criteria were modified.

Enterprise Community Partners, the county, FrontLine, and Third Sector finalized the PFS contract, which was formally approved by the Cuyahoga County Council in October 2014. By December, national and local funders had formally committed and entered into lender and grant agreements.[47]

Financing

In December 2014, after a year of conversations and various due diligence processes, Third Sector received formal commitments from the project's national and local funders. A consortium of five funders would provide up-front funding of $4 million for the program, anchored by a senior loan of $1,575,000 at 5 percent interest from Reinvestment Fund, a national community development finance institution that focuses on neighborhood revitalization.[48] The remainder came from subordinate philanthropic loans with interest rates varying from 0 percent to 2 percent and from recoverable grants[49] from the Nonprofit Finance Fund, the George Gund Foundation, the Cleveland Foundation, and the Sisters of Charity Foundation of Cleveland.

The project's target impact is a 25 percent reduction in OHP days. If that goal is met, the county will realize modest net savings, and all funders will be repaid their principal investment with base annual interest. If the reduction in OHP days is greater than 25 percent, the county's savings will be substantially greater, and funders will receive up to $1 million in success payments.[50] The program's investors received $75 per OHP day saved.[51]

All other project agreements, including those with the Poverty Center, Enterprise Community Partners, and Third Sector, were also finalized in December 2014. It is worth noting that none of the stakeholders had anticipated the legal complexities and costs of drafting and negotiating the PFS contract.[52]

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47 Enterprise Community Partners & Third Sector Capital Partners. (2016).

48 Id.

49 Success fees would be dedicated to other charitable purposes.

50 County of Cuyahoga. (2017); County of Santa Clara & Abode Services. (2015).

51 County of Cuyahoga. (2017). *Fact Sheet: The Cuyahoga Partnering for Family Success Program*. Retrieved January 16, 2019, from http://www.thirdsectorcap.org/wp-content/uploads/2017/03/Cuyahoga_PFS_Fact-Sheet_UPDATED-MAR-2017.pdf; and County of Santa Clara & Abode Services. (2015). *Project Welcome Home Fact Sheet.* Retrieved January 16, 2019, from http://www.thirdsectorcap.org/wp-content/uploads/2015/08/150811_SCC-CH-PFS_Fact-Sheet.pdf.

52 Enterprise Community Partners & Third Sector Capital Partners. (2016).

The Launch and Subsequent Tracking

The project team publicly announced the launch of the project in Cuyahoga County in late December 2014.[53] Since that time, evaluators have released a study that identified treatment group characteristics, reviewed the case management process for clients, and made a preliminary assessment of the project's impact on clients and service delivery.[54] In addition to revealing early signs of success (the treatment group was less likely to require housing services than the control group), the evaluation identified procedural recommendations to improve coordination between FrontLine and county workers.

Project enrollment ended in September 2017, and outcomes tracking continues through December 2019..The program will have a single payment, to be calculated and made in the first quarter of 2020.

See the appendix for other examples of PFS programs concerned with families and children.

Other PFS Programs

Governments in the United States and around the world are increasingly developing and implementing PFS in areas ranging from health to education, from homelessness to the environment. Here we survey some of these projects.

Early Childhood Education

A number of PFS initiatives provide early childhood education with the goal of reducing at-risk children's need for special education and, more broadly, preventing educational deficits from reducing their life opportunities.

Utah School Readiness Initiative (2013). A consortium of public school districts and private organizations provided high quality preschool education to approximately 4,000 low-income three- and four-year-olds between 2013 and 2018.[55] The project sought to lower the need for special education services in later years of schooling by preparing children to remain on track in

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[53] Third Sector Capital. Retrieved February 20, 2019, from https://www.thirdsectorcap.org/portfolio/cuyahoga-county-partnering-for-family-success-program/ .

[54] R. Bai, C. C. Collins, D. Crampton, C. Liu, & R. Fischer (2017). Cuyahoga Partnering for Family Success Process Evaluation 2017. *Briefly Stated*, 17(1). Retrieved January 28, 2019, from http://povertycenter.case.edu/wp-content/uploads/2017/07/Briefly_Stated_No_17-01_Cuyahoga_Partnering_for_Family_Success.pdf.

[55] https://www.deseretnews.com/article/900054770/this-utah-preschool-program-helped-inspire-a-us-law-that-will-create-a-dollar100-million-fund-heres-what-its-for.html.

elementary and high school. United Way of Salt Lake and Salt Lake County committed to paying for the success of the first cohort, with appropriations from the State of Utah paying for subsequent cohorts. Goldman Sachs's Social Impact Fund made a $4.6 million loan to the providers as senior lender, and the J. B. and M. K. Pritzker Family Foundation lent $2.4 million as the subordinate lender. United Way of Salt Lake, a Utah nonprofit, has served as the program intermediary, overseeing implementation and managing repayments to investors.[56]

Using results of the Peabody Picture Vocabulary Test (PPVT), United Way of Salt Lake identified 110 children (within a cohort of 595 children) as likely to need special education and enrolled them in early childhood education programs. Only one of those students ended up actually needing special education services in kindergarten—almost a 100 percent success rate. The PFS contract provided that investors would receive a repayment equal to 95 percent of the savings brought to the state by the program. With the first cohort, the payers saved $281,550[57]; Goldman Sachs received a $260,000 repayment.[58]

Experts voiced considerable skepticism about the program's actual effectiveness. Most early childhood education programs—even those better funded than Utah's—have much lower success rates, typically 10 percent to 20 percent. It is noteworthy that, unlike many of the recidivism programs, the Utah School Readiness Initiative's payments were not based on a conventional evaluation technique that compared participants in the program with similarly situated children who did not participate, but solely on children's PPVT scores. This decision left open the possibility that the program's spectacular success was based on the erroneous assumption that a high percentage of the children who scored low on the PPVT would otherwise have required special education.[59]

Chicago Child-Parent Center Initiative (2014). In a pre-K education PFS program with goals similar to Utah's, the Child-Parent Center provides early childhood education to increase

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[56] Goldman Sachs. (2015). Initial Results Released for First Social Impact Bond for Early Childhood Education Show Success: 109 of 110 At-Risk Utah Students Avoid Special Education Services Following Preschool. Retrieved February 9, 2019, from http://www.goldmansachs.com/what-we-do/investing-and-lending/impact-investing/case-studies/sib-slc-fact-sheet.pdf.

[57] Calculated from the state's additional per child funding of $2,607.

[58] Goldman Sachs. (2015).

[59] Doubts were also expressed about the predictive validity of the PPVT. In this regard, see A. Loewenberg (November 6, 2015). *"Pay for Success" Gaining Traction as ECE Funding Option, But Should It Be?* Retrieved April 23, 2017, from https://www.newamerica.org/education-policy/edcentral/payforsuccess/; and N. Popper. (November 3, 2015)." Success Metrics Questioned in School Program Funded by Goldman," *New York Times*. Retrieved February 9, 2019, from https://www.nytimes.com/2015/11/04/business/dealbook/did-goldman-make-the-grade.html.

kindergarten readiness, improve third-grade literacy, and reduce the need for special education. In addition to delivering high quality preschool services, the program provides support to parents. It aims to reach a total of 2,618 children over four years. The pilot cohort comprises 374 children—four-year-olds from families living below the poverty level who attend schools in low-income communities where there is a shortage of high quality preschool education opportunities.[60]

The program's success in achieving special education outcomes is based on a comparison group of children from similar neighborhoods and with similar demographic characteristics who did not attend preschool. In contrast, success with respect to kindergarten readiness and literacy outcomes is based not on a comparison group, but on students' performance on the Partnership for Assessment of Readiness for College and Careers test.[61] Lenders are repaid if, on average, the children score above the 25th national percentile. SRI International, the independent evaluator for the project, released the results of the first cohort in the spring of 2016. SRI found that 59 percent of the participating children showed kindergarten readiness rates above the national average. Like the Utah program, the $16.6 million Chicago project was funded by Goldman Sachs's Social Impact Fund. Additional money came from Northern Trust as a senior lender and the J. B. and M. K. Pritzker Family Foundation as subordinate lenders.[62] The investors received a success payment of $500,000 based on the program's outcomes.

Homelessness

Santa Clara County Project Welcome Home (2015). In 2015, Santa Clara County, California, launched Project Welcome Home to serve 150–200 people who are chronically homeless and use emergency rooms, jails, and other government-funded services at a disproportionate rate. Abode, the service provider, offers housing placement and support services (for example, search, lease negotiation, conflict mediation) and access to additional care such as crisis intervention, mental health and primary care treatment, and substance use counseling. Abode pursues two complementary approaches shown to reduce hospitalization and homelessness. "Housing First" provides immediate housing without conditions concerning substance use or program

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[60] https://iff.org/chicago-pay-success-initiative/; https://www.payforsuccess.org/project/chicago-child-parent-center-pay-success-initiative.

[61] The Partnership for Assessment of Readiness for College and Careers (PARCC) is a consortium of eight states, the District of Columbia, and the Bureau of Indian Education that work together to create and deploy a standard set of K–12 assessments in Mathematics and English based on the Common Core State Standards. Retrieved February 25, 2019, from https://parcc.pearson.com/.

[62] Chicago SIB Authorizing Ordinance. (2014).

participation. "Assertive Community Treatment" provides comprehensive treatment for mental and physical illnesses and substance abuse.[63]

Using the services of Third Sector, the project intermediary, the county lined up $6.9 million in funding from private funders and philanthropic organizations, and (somewhat unusually) from the service provider's deferred service fee.[64]

With these interventions, the goal is to increase "continuous stable tenancy" to at least 12 months for more than 80 percent of enrollees.[65] (A "month" of continuous residency allows for a participant to spend up to 14 days incarcerated or hospitalized). Santa Clara County begins issuing success payments when a participant achieves 3 months of continuous tenancy, and payments increase after each 3-month milestone for a year. The county will pay a total of $12,240 for a participant who maintains stable tenancy for 12 months. Table 2 shows the milestones that trigger progressive repayment.

Participant Milestone **# months of continuous tenancy**	**Success Payment per Participant**
3 months	$1,242
6 months	$1,863
9 months	$2,484
12 months	$6,831
Cumulative payment through 12 months	$12,240
Each month after the first year of stable tenancy	$1,035

Table 2. Success Payment per Participant for Project Welcome Home. (County of Santa Clara & Abode Services, 2015)

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[63] E. A. Latimer. (1999). "Economic Impacts of Assertive Community Treatment: A Review of the Literature," *The Canadian Journal of Psychiatry* 44(5), pp. 443–454. Retrieved January 25, 2019, from https://doi.org/10.1177/070674379904400050.

Legislature of the State of Texas. An Act Relating to the Administration of "Pay for Success"; Contracts for State Agencies, Pub. L. No. HB 3014 (2015). Retrieved February 2, 2019, from http://www.payforsuccess.org/sites/default/files/resource-files/84r_hb_3014_-_enrolled_version_-_bill_text.pdf .

[64] County of Santa Clara & Abode Services. (2015).

[65] Ibid., p. 3.

If overall outcomes reach the target level of impact, the success payments will fully repay funders their principal investment with annual interest. If the outcomes exceed the target, funders receive additional success payments, up to a cap of $8 million. (The University of California San Francisco School of Medicine is conducting an RCT to measure the program's effectiveness, but not for purposes of payment.)[66]

(See the Appendix for other examples of PFS programs addressing homelessness.)

MENTAL HEALTH

Santa Clara County Partners in Wellness Project (2016). The county hopes to reduce the costs of treating its acutely mentally ill population, many of whom are repeat users of the county's emergency and inpatient mental health facilities. For example, in recent years, more than one quarter of the nearly 7,000 patients who used these facilities were readmitted. Patients requiring emergency services use the county's Emergency Psychiatric Services (EPS) and then transfer either to one of the contract hospitals or to the Barbara Arons Pavilion (BAP), a 48-bed acute inpatient psychiatric facility. Because the county lacks space for patients who no longer need acute inpatient care, many of them stay at BAP for an unnecessarily long time, occupying "acute beds." This forces the county to send patients who need acute care to contract hospitals outside the county system at a cost of millions of dollars per year.[67]

In December 2014, Santa Clara County retained Third Sector as an intermediary and issued a request for proposal for a PFS contract with a service provider that could care for the mentally ill in a less restrictive environment than the county facilities. The contract was awarded to Telecare Corporation, a for-profit organization with considerable experience in this field. The beneficiary population includes at least 250 severely mentally ill people who have been previously admitted to an inpatient facility. The six-year project aims to improve the health and well-being of this population while lowering the county's costs through reduced and more efficient use of emergency and inpatient psychiatric services. The county hopes to save at least $5 million.

Telecare's remuneration will be based on its success in reducing client use of high-cost services. The reduction targets are based on the historical use by the beneficiary population, with payments based on an estimate of how much the county expects to save when those targets are

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[66] UCSF is using an Intention to Treat approach, which compares people assigned to the treatment group with the control group, regardless of whether the people in the treatment group actually enroll for permanent supportive housing. It is also measuring other outcomes not tied to success payments, such as use of primary care, hospital and emergency room, mental health, and substance use services.

[67] D. Schifrin & P. Brest. (2016). *Pay for Success and Social Innovation Financing: Serving Santa Clara County's Mentally Ill Residents* (Stanford Graduate School of Business Case No. SI-133). Stanford, CA.

met.[68] Although payments are not based on an RCT, a professor in the Stanford School of Medicine Department of Psychiatry is conducting an RCT to gather evidence about the program's efficacy. In addition, clients will be surveyed to determine their subjective well-being.

Although development of the program benefited from grants from the James A. Irvine Foundation, Nonprofit Finance Fund, and California HealthCare Foundation, the county and Third Sector decided not to look to foundations or commercial investors to front the working capital, instead opting to pay Telecare directly.[69]

Workforce Development

Massachusetts Pathways to Economic Advancement (2017). Limited English language skills make it difficult for many immigrants in the greater Boston area to get jobs. A PFS project launched by Massachusetts in 2017 aims to increase employment opportunities for adult language learners through English language classes, vocational training, and job search assistance.[70]

Jewish Vocational Service will deliver these services to nearly 2,000 immigrants and refugees over three years.[71] Social Finance raised $12.43 million for the project from 40 investors, including financial institutions, donor advised funds, individuals, and foundations. Prudential Financial, in collaboration with Maycomb Capital, provided nearly 50 percent of the total investment. Bank of America Merrill Lynch acted as the placement agent for certain qualified high net worth and institutional investors.[72] The commonwealth's repayment of investors is based on JVS clients' successful engagement with the program, improvement in earnings, and transition to

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[68] Basing payments on anticipated rather than actual savings limits the role of factors outside Telecare's control that might affect the county's actual savings. Email from Greta Hansen to Paul Brest. July 22, 2016.

[69] Third Sector Capital Partners, County of Santa Clara, Telecare Corporation, & Corporation for National & Community Service. (2017). *Partners in Wellness Fact Sheet*. Retrieved February 1, 2019, from http://www.thirdsectorcap.org/wp-content/uploads/2017/02/Partners-in-Wellness-Fact-Sheet-Final.pdf.

[70] Social Finance. *Massachusetts Pathways to Economic Advancement Pay for Success Project Fact Sheet*. Retrieved February 12, 2019, from http://socialfinance.org/content/uploads/MAPathways_FactSheet.pdf.

[71] Nonprofit Finance Fund. *Pay For Success blog* (2018). Massachusetts Pathways to Economic Advancement. Retrieved September 16, 2018, from https://payforsuccess.org/project/massachusetts-pathways-economic-advancement and Social Finance. *Massachusetts Pathways to Economic Advancement Pay for Success Project Fact Sheet*. Retrieved February 12, 2019, from http://socialfinance.org/content/uploads/MAPathways_FactSheet.pdf.

[72] Other investors include Living Cities Blended Catalyst Fund, Combined Jewish Philanthropies' Donor Advised Funds, Barbara Bush Foundation for Family Literacy, ImpactAssets via the Giving Fund of Blue Haven Initiative, the Boston Foundation, Boston Impact Initiative, the Inherent Foundation, the Kresge Foundation, the Shapiro Foundation, the Sorenson Impact Foundation. *Massachusetts Pathways to Economic Advancement Pay for Success Project*. Retrieved February 12, 2019, from http://socialfinance.org/focus-areas/workforce/massachusetts-pathways-economic-advancement-project/.

higher education. The project consists of four distinct program tracks to accommodate varying language levels, personal resources, employment objectives, and educational goals. The success of the program tracks will be assessed by various evaluation methods. For example, the Skills Training program will be assessed by comparing how much a participant earned before and after enrolling in the project. The English for Advancement program, on the other hand, will be evaluated by assessing how the participants are performing in comparison to a control group of similar people who were not part of the project.[73]

Veterans Coordinated Approach to Recovery and Employment (2018). Veterans CARE was launched in 2018 to provide Individual Placement and Support (IPS) services over three years to 480 unemployed and underemployed veterans in New York City, Boston, Brockton, and central and western Massachusetts who have been diagnosed with Post-Traumatic Stress Disorder (PTSD). The project, coordinated by Social Finance, is the first PFS project in the United States to focus on improving employment outcomes for veterans and the first multistate project of its kind.[74] The services will be delivered by IPS teams at local VA Medical Centers, with coordination and technical assistance provided by the Tuscaloosa VA Medical Center. The success of the project will be measured by Westat on the basis of increased earnings, sustained employment, job satisfaction, and fidelity to the IPS model. BNP Paribas, Northern Trust, the Dakota Foundation, Deutsche Bank, and the Robin Hood Foundation are responsible for the initial investment of approximately $5 million. If the program is successful, the principal amount plus interest will be repaid to the investors by the US Department of Veterans Affairs, Massachusetts; the Economic Development and Industrial Corporation of Boston; and the New York City Department of Veterans Services.

Environment

DC Water Environmental Impact Bond (2016). In 2016, the DC Water and Sewer Authority launched the first-ever environmental PFS project. It is building green infrastructure to improve DC's water quality. Goldman Sachs and the Calvert Foundation pledged $25 million, which will

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73 Jewish Vocational Service, Social Finance (2017). Pay for Success blog. Massachusetts Pathways to Economic Advancement—A Next Generation of Pay for Success Project. Retrieved February 24, 2019, from https://payforsuccess.org/blog/massachusetts-pathways-economic-advancement-next-generation-pay-success-project.

74 Nonprofit Finance Fund. Pay for Success blog. (2018). *Veterans Coordinated Approach Recovery and Employment Care*. Retrieved February 12, 2019, from https://www.payforsuccess.org/project/veterans-coordinated-approach-recovery-and-employment-veterans-care; Social Finance. *Veterans Coordinated Approach Recovery and Employment Care Fact Sheet.* Retrieved February 12, 2019, from http://socialfinance.org/content/uploads/Veterans-CARE_FactSheet.pdf; and Social Finance. (2018). *VA partner organization launch innovative approach using long term employment to improve lives of veterans with PTSD*. Globenewswire. Retrieved November 1, 2018, from https://globenewswire.com/news-release/2018/10/03/1600900/0/en/VA-partner-organizations-launch-innovative-approach-using-long-term-employment-to-improve-lives-of-Veterans-with-PTSD.html.

be repaid on the basis of outcomes in storm water runoff reduction with an initial 3.43 percent interest coupon, payable semiannually, for the first five years.[75]

[75] The stated maturity date is October 1, 2046. The mandatory tender date is April 1, 2021. Goldman Sachs, DC Water, & Calvert Foundation. (2016). *Fact Sheet: DC Water Environmental Impact Bond*. Retrieved January 28, 2019, from http://www.goldmansachs.com/media-relations/press-releases/current/dc-water-environmental-impact-bond-fact-sheet.pdf, and retrieved February 20, 2019, from https://www.epa.gov/sites/production/files/2017-04/documents/dc_waters_environmental_impact_bond_a_first_of_its_kind_final2.pdf.

Part Three: Analysis

The Government's Role

Governments' motivations for operating PFS programs include improving the lives of beneficiaries, providing social services more cost-effectively, changing the governments' own cultures to be more outcome-oriented, and minimizing the risk of unproven programs.

Imagine that you are a senior official or administrator of a government agency. On any given day, many issues compete for your attention. A PFS project is costly, novel, and complex. It requires interrupting business as usual and subordinating other priorities. You will have to invest political, social, reputational, and financial capital to get the project off the ground and keep it flying.

For all of these sunk costs, the benefits are unknown. Although PFS may reduce certain risks, it is fraught with others:

- *Nonperformance risk*, if the intervention does not achieve its specified outcomes. The service provider and any outside investors bear the greatest financial risks of nonperformance. But the government itself has much to lose: failing to achieve its social goals and the loss of reputation and political capital.
- *Termination risk*, if any of the other major parties decides to withdraw, whether justified by the contract or not.
- *Unanticipated costs*. Almost all PFS contracts to date have taken more time, cost more money, and consumed more human resources than anticipated by the parties.

Given these risks and costs, a PFS project requires an advocate who has the authority and will to shepherd a project from concept to completion, as well as staff who can slog through the long path from designing to operating and monitoring a contract.

High-level government champions have played critical roles in many PFS projects:

- New York State's recidivism PFS program was part of Governor Andrew Cuomo's policy agenda in his campaign for governor.[76]

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[76] State of New York, Center for Employment Opportunities, & Social Finance. (2014).

- The New York City recidivism PFS program originated in Mayor Michael Bloomberg's Young Men's Initiative, focused on "improv[ing] the lives of black and Latino men."
- Mayor Ben Adams of Salt Lake County made it a priority to collaborate with the local United Way to improve outcomes for disadvantaged children.
- Gary Graves, Santa Clara County's Chief Operating Officer, initially doubted that the proposed Welcome Home PFS project could reduce the county's costs in caring for homeless people. But after the Board of Supervisors concluded that it was worth tackling a high priority social problem even if the project did not save money, his commitment made it possible for the project to take root.[77]
- In reviewing the Massachusetts Juvenile Justice initiative, Third Sector noted that "having a government champion to actively promote PFS is essential. Governor Deval Patrick's public support of PFS was necessary for the project's success."

But senior leadership is only the start. Greta Hansen, Chief Assistant County Counsel of Santa Clara County, California, who has been the lead on two PFS projects, notes that it requires at least one dedicated staff member with "the desire, the bandwidth, and the capacity" to undertake the project and stay with it through implementation. The staff member must grasp economic and statistical models, finance vehicles, the service provider's operations, and clients' needs, as well as negotiate complex legal contracts. It is not surprising that, even with the assistance of intermediaries, many governments initiating PFS projects have dedicated a full-time staff member to them.[78]

PFS also calls for a change in the government's mindset and practices from procuring services to active contract management with the aim of achieving measurable outcomes. It is not only the initiating agency that needs to be reoriented. Most social problems affect multiple government agencies, each of which has its own jurisdiction, budget, mission, staff, and operating procedures. Recall the many agencies involved in New York State's project to reduce recidivism and Cuyahoga

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[77] Eleanor Clement Glass, Chief Giving Officer of Silicon Valley Community Foundation, a supporter, stated, "Seeing the County's commitment at multiple levels and Gary's leadership addressed a threshold question that permitted us to consider supporting this project." https://healthtrust.org/wp-content/uploads/2015/11/From-Idea-to-Action-Pay-for-Success-in-Santa-Clara-County-Report.pdf.

[78] US GAO. (2015). *Pay for Success: Collaboration among Federal Agencies Would Be Helpful as Governments Explore New Financing Mechanisms*. Washington, DC. Retrieved February 12, 2019, from https://www.gao.gov/products/GAO-15-646. In a review of the Massachusetts Juvenile Justice Project, Third Sector Capital said, "It proved essential that the government was able to allocate dedicated personnel to the development of the project."

S. Kodali, J. Grossman, & G. Overholser (2015). The Massachusetts Juvenile Justice PFS Initiative: Lessons Learned, p. 9. Retrieved from http://www.thirdsectorcap.org/wp-content/uploads/2015/02/TSCP_MAJJ-PFS-Lessons-Learned.pdf.

County's project to protect vulnerable families. But even agencies that are not involved in the project may be affected by its activities and outcomes. For example, Santa Clara County's Project Welcome Home affects the county's Office of Supportive Housing, Emergency Medical Services, the Public Health Department, the Health and Hospital System, Behavioral Health Services, the County Sheriff's office, the county jail, the judicial system, the Department of Corrections, the Parks and Recreation Department, Reentry Services, and Veterans Services. The project also affects agencies in the county's cities, such as East Palo Alto and San Jose, as well as large unincorporated areas such as Stanford University.

In practice, PFS programs may create opportunities and incentives for collaboration among government agencies that increase efficiency and improve outcomes for their shared beneficiaries. In an ideal world, the various government entities that enjoy these benefits would contribute to the costs of the projects. In reality, they don't. Leaving aside the costs of coordination, projects of this sort often face what the Urban Institute terms "wrong pocket problems," where one government entity pays the costs of an intervention while others benefit from the savings it creates.[79] Wrong pocket problems fall into several categories:

- *Intra-agency*: one or more divisions within a single agency (such as police, probation, courts, corrections, and parole within the criminal justice system) pay for a program, but another division within that same agency receives the benefits.
- *Interagency*: one agency (such as the criminal justice system) pays the cost of a program, but another agency (such as the public health system) receives the benefits.
- *Time*: one executive or legislative administration pays the costs of a program, but a future administration receives the benefits.
- *Regional governance*: one place (such as a city government) pays the costs of a program, but a different place (such as a bordering county) receives the benefits.
- *Intergovernment*: one level of government (such as a municipal government) pays the costs of a program, but another level of government with jurisdiction in the same geography (county, state, or federal) receives the benefits.
- *Inter-sectoral savings*: residents benefit from the program, but the savings are not reflected in any government budget; although society benefits, government agencies cannot capture that benefit.[80]

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[79] J. K. Roman. (2015). *Solving the Wrong Pockets Problem: How Pay for Success Promotes Investment in Evidence-Based Best Practices*. Washington, DC. Retrieved February 12, 2019, from http://www.urban.org/sites/default/files/publication/71501/2000427-solving-the-wrong-pockets-problem_1.pdf.

[80] Ibid., p. 3.

Pay for Success programs can mitigate these problems by drawing on citywide, countywide, or statewide budgets.

REQUISITES FOR A PFS PROJECT FROM THE GOVERNMENT'S PERSPECTIVE

Although the government and service provider have many shared interests, it is useful to look at the requisites for a PFS project separately from the government's and the service provider's perspectives. From a government standpoint, the ideal PFS project has five characteristics:

- Quantifiable benefits of the expected outcomes
- Predictable likelihood of success
- Predictable costs and benefits
- Reliably measurable outcome metrics not vulnerable to strategic behavior
- No unintended negative consequences

For the recidivism programs, there are fairly good data on the costs of incarcerating a prisoner.[81] The overall cost savings include the marginal costs of avoiding housing one inmate over a set period of time and, ideally, the fixed costs of closing facilities if the total prison population decreases by a certain amount. A study by the State of Maryland summarized:

> The majority of cost savings from a reentry program are associated with avoided reimprisonment. Within this category, the largest cost savings come when an agency can close a wing of a prison or an entire prison due to a drop in the number of prisoners. In Maryland, this typically requires a reduction of at least a few hundred prisoners per year. Until this threshold is obtained, Department of Public Safety and Correctional Services can only save on marginal costs for inmate wages, contractual services, materials, supplies, food and medical costs. These marginal costs are approximately $4,623 per inmate per year for the department.[82]

In the New York State PFS program described above, the jurisdictions estimated the annual marginal costs of a prisoner is $31,000[83]

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81 C. Henrichson & R. Delaney. (2012). *The Price of Prisons: What Incarceration Costs Taxpayers*. New York, NY. Retrieved February 12, 2019, from https://www.vera.org/publications/price-of-prisons-what-incarceration-costs-taxpayers.

82 K. A. McKay. (2013). *Evaluating Social Impact Bonds as a New Reentry Financing Mechanism: A Case Study on Reentry Programming in Maryland*. Annapolis, MD. Retrieved February 10, 2019, from http://mgaleg.maryland.gov/Pubs/BudgetFiscal/2013-Evaluating-Social-Impact-Bonds.pdf.

83 Estimated annual marginal costs of a prisoner. Note: New York's estimate from the Detailed Project Summary (2014) converted the marginal cost per day to an annual cost.

Social costs are more difficult to quantify and are based on subjective judgments. In the case of recidivism, they include

- Costs to ex-offenders. "At the time of their release, felons return to the community with norms and attitudes that are maladaptive to society outside of the prison walls. Compounding the problem, many—perhaps most—have weak labor market attachments and social supports. Reentry programming can provide a highly socially valuable set of services, independent of the fiscal impact, that contribute toward stronger and safer communities when former inmates are able to begin rebuilding healthy and productive lives."[84]
- Costs to victims, including lost earnings and medical costs from the injury, property loss or damage, jury compensation to victims,[85] and the costs of citizens not feeling safe on the streets and in their homes.

The social consequences of reducing homelessness, providing early childhood education, and supporting families are if anything more subjective, more varied, and more difficult to measure. Different government jurisdictions may place different values on healthy lives, fulfilled lives, and, indeed, just plain lives. The time horizon of the impact also can extend far into the future. Ironically, because placing value on social outcomes is fundamentally a political decision, the subjectivity inherent in valuing outcomes does not pose a greater problem for the adoption of PFS projects than it does for allocating funds for, say, street beautification or pothole repairs.

In sum, the requirement of quantifiable benefits does not create significant barriers for most PFS programs.

Predictable Likelihood of Success

A fundamental requisite of a PFS contract is that the parties have good reason to believe that the program will succeed in achieving their mutually agreed outcomes. For all practical purposes, this means having confidence in the theory of change that underlies the program and in the service provider's ability to implement the program. This requires that prior similar programs have been well evaluated and that the evaluation results are generalizable to the context in which the program will operate.

Evaluation

The fundamental purpose of program evaluation is to determine whether a program caused its intended outcome. Evaluation answers two questions: (1) did the desired outcome occur at all, and if so, (2) would the outcome have occurred (to the same extent) even without the program.

84 McKay. (2013, p. 11).

85 State of New York, Center for Employment Opportunities, & Social Finance. (2014).

Consider the example of a teen pregnancy prevention program. Assuming that one can track program participants, the first question is relatively easy to answer: each participant who did not become pregnant within some predefined period counts as a desired outcome. The second question is more difficult to answer: would that teenager *not* have become pregnant even if she hadn't participated in the program? Answering it involves comparing the actual results of the program to the counterfactual: What would have happened in the program's absence?

(Note that we are considering evaluation here as a way of *predicting* the success of a service-delivery program. We will return to evaluation later as method for *retroactively assessing* the success of a program.)

Generalizability

Even if a past implementation of a similar program has been highly successful, differences between that program and the proposed one—for example, differences between their beneficiaries or between their social or economic environments—often make it difficult to predict success.

To use a simple example, suppose that in the Santa Clara County's homelessness project, Abode's approach to providing permanent supportive housing reduced homelessness among a group of volunteers in the city of San Jose. Consider why the program might not be as successful if it were made available to *all* the homeless people in that city. And consider why a similar program might not be as successful in rural parts of the county, or in other US cities, or in developing countries. In the first case, volunteers may exhibit a motivation to live in stable housing that isn't necessarily shared by the population at large. In the second case, transportation systems, social services, employment opportunities, and the availability of alcohol and drugs may differ significantly from one locale to another. The problem can occur even with the same program conducted some years later by the same provider in the same locale for the same population of clients, when the external environment may have changed.

Assessing external validity is as much art as science. One must consider salient variables, differences in those variables introduced over time and space, and what effect the differences may have on a program's outcomes.

Prediction can be improved by understanding the particular mechanisms by which the intervention works[86] and by multiple replications of a strategy in different settings, as in the case of Nurse Family Partnership. But replication is expensive, and there are not many programs for which there is strong evidence.

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[86] Mary Ann Bates & Rachel Glennerster. (2017). "The Generalizability Puzzle," *Stanford Social Innovation Review*. Retrieved February 12, 2019, from https://ssir.org/articles/entry/the_generalizability_puzzle.

Predictable Costs and Benefits

A PFS contract requires being able to make reasonably good predictions about the extent to which interventions will bring about outcomes and the costs of achieving those outcomes. Both parties must determine how success will be measured and must specify the dollar value of each positive outcome. In addition—a matter we postpone to a later section—the service provider must estimate the cost of treating a cohort of participants in order to determine the net cost of providing a single outcome, such as an ex-offender who does not offend again.

Let's return to the hypothetical PFS project to reduce teen pregnancy. To state the obvious, in our example, the intended outcome is a pregnancy avoided. We need to estimate:

- *The value of an avoided teen pregnancy*. The government might estimate the net present value of avoiding a teen pregnancy as $75,000.[87] This figure might be based on the costs to the potential mother (such as health expenses; forgone employment, education, and opportunity) and the costs to the potential child, whose mother may lack the ability to provide adequate care. Although the government may be willing to pay the service provider up to the full value of $75,000 per pregnancy avoided, it may begin negotiations with a lower offer.
- *The base rate of teen pregnancies in the targeted group*. The government ideally would pay the service provider only for its *impact*—for participants in the program who do not get pregnant but otherwise would. A necessary starting point is the base rate of pregnancies for the population treated by the program. There is reasonably good social science evidence about the teen pregnancy rates for girls with different demographic characteristics in various geographic locales—though any estimate for the particular population served by the program will be subject to a considerable margin of error. For illustrative purposes, our hypothetical program focuses on girls "at risk" of becoming pregnant, among whom 20 percent actually do.
- *The program's impact*. The program's success rate, or impact, is the difference between the percentage of participants in the program and the percentage of participants in similar populations that attained the outcome. If 20 percent of high-risk teenage girls in the relevant population become pregnant and only 7 percent of those enrolled in the program are likely to get pregnant, the impact would be 13 percentage points or 65 percent.

Reliably Measurable Outcome Metrics Not Vulnerable to Strategic Behavior

- There is a single specified quantifiable outcome metric, or at most a couple.

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[87] This is a conservative estimate. See National Campaign to Prevent Teen and Unplanned Pregnancy. (2014). *Counting It Up: Total Costs to Taxpayers*. Washington, DC. Retrieved February 12, 2019, from https://thenationalcampaign.org/sites/default/files/resource-primary-download/total-costs.pdf.

- The outcome metric is identical to the ultimate outcome that the government desires, or a very closely correlated proxy for the ultimate outcome.[88]
- The program is relatively immune to strategic behavior such as creaming and outright cheating.

Our teen pregnancy prevention program has a single outcome: a participant does not become pregnant within a specified time (e.g., while in the program plus a specified number of months or years afterwards). The metric is clear: As the saying goes, one cannot be a little bit pregnant. It is not always easy to obtain the relevant data, however. It is difficult to track girls who drop out of the program; schools may be legally prohibited from sharing the information, if they have it. Unless it is part of a mandatory school curriculum, participants must volunteer for the program, leading to the possibility that it attracts girls who are less likely than their peers to become pregnant. The program may be more or less susceptible to the service provider's strategic behavior in recruiting participants.

We should note that the downside of focusing on quantifiable metrics and easily obtainable data is that the programs may not take adequate account of other important outcomes, such as the subjective well-being of their clients. To address this problem, Santa Clara County's mental health program supplemented the readily obtainable administrative data relating to cost savings with a survey of the service provider's clients' physical and psychological well-being.

The addition of survey data to administrative data in Santa Clara County's Partners in Wellness Project necessarily adds an expense; the South Carolina Nurse-Family Partnership PFS program relies exclusively on survey data. Survey data almost inevitably adds an incremental cost to a program where administrative data is, by hypothesis, already being collected. The reliability of both forms of data is highly dependent on context—on the nature of the data and the standards, methods, professionalism, and objectivity of the data collector.[89] Where administrative data can provide a reasonably good proxy, the parties to a PFS program may rely on the administrative data and use surveys as spot-checks.

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[89] An excellent paper on *Barriers to Using Administrative Data for Evidence-Building*, prepared by the Office of Management and Budget for the White House Commission on Evidence-Based Policymaking, describes not only barriers to sharing administrative data but potential solutions, such as regulatory reforms and data clearinghouses. Office of Management and Budget. (2016a). *Barriers to Using Administrative Data for Decision Making*. Washington, DC. Retrieved February, 14, 2019, from https://obamawhitehouse.archives.gov/sites/default/files/omb/mgmt-gpra/barriers_to_using_administrative_data_for_evidence_building.pdf).

No Unintended Negative Consequences

- The provider's efforts to achieve the outcome *do not crowd out other valuable outcomes*.[90]
- The provider's efforts to achieve the outcome *do not create negative externalities*.

When school districts and teachers are rewarded on the basis of students' performance on math and reading tests, educators may focus on those subjects to the exclusion of others. Because PFS programs inevitably induce service providers to teach to the test, they may be vulnerable to the same phenomenon. We don't see this as an issue for any of the programs described above, however.

Nor do these programs seem to create negative externalities—that is, harms to others. Job training and placement programs do, however, create the possibility of displacement: the program's beneficiaries may simply take jobs now held by others.[91]

Application of the Criteria to Various PFS Programs

Let's analyze some of the criteria considered above as applied to some PFS programs.

Recidivism

Days in prison avoided translate directly into cost savings for the government.[92] Reduced criminal conduct also has social benefits for the potential victims of crime and the ex-offender himself. As explained in CEO's Project Summary, "the bed days measure captures both the budgetary costs of incarceration and the victim and community impacts of new crimes since serious crimes result in longer sentences."[93] As we mentioned above, most US jurisdictions maintain reliable administrative data on whether a person is in prison. The Massachusetts Juvenile Justice PFS

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90 The paradigmatic example of crowding out occurs in education, where measuring only select subjects such as reading and math scores may crowd out science, arts, and other subjects.

91 B. Crépon, E. Duflo, M. Gurgand, R. Rathelot, & P. Zamora. (2013). "Do Labor Market Policies Have Displacement Effects? Evidence from a Clustered Randomized Experiment," *The Quarterly Journal of Economics*, 128(2), pp. 531–580. Retrieved February 12, 2019, from http://dx.doi.org/10.1093/qje/qjt001. A related issue is the equilibrium effect, when a program successfully serves its entire eligible population (A. V. Banerjee & E. Duflo. (2009). "The Experimental Approach to Development Economics," *Annual Review of Economics* 1(1), pp. 151–178). Consider the possible equilibrium effect of scaling up a homelessness program whose success depends heavily on training and placement for low-wage jobs if the number of available jobs in the area is highly limited.

92 The greatest cost savings would come from reducing recidivism enough to close a jail—probably an unattainable objective for most PFS projects.

93 State of New York, Center for Employment Opportunities, & Social Finance. (2014).

project bases its main performance metric on the length of the prison sentence rather than actual days in prison.[94]

The danger of creaming—of a service provider's selecting only clients who are predicted to succeed in the program—is highly unlikely to occur in any of the existing anti-recidivism projects, because the service provider lacks control over who is placed in the program.[95]

Beyond biased selection of participants, a service provider might bias its provision of services to those participants who seem most likely to succeed. The classic example of such triage has occurred as a result of high-stakes testing in education; teachers have an incentive to dedicate more effort to so-called bubble kids who are just below a cut-off point than to students further below or above the line.[96] In contrast to education, which has norms of equal treatment, however, the payer in a recidivism PFS project may not object to a service provider's strategy of giving more attention to ex-offenders who are less likely to re-offend.[97] Of course, some ex-offenders wouldn't relapse even if they received no treatment at all, but a well-designed PFS contract will not pay for them.

Are recidivism PFS projects vulnerable to other forms of gaming, in which seemingly successful client outcome would not actually satisfy the government's interests? To use an outlandish example, rather than reducing a client's likelihood of reoffending, a service provider might teach him how to avoid getting caught when he commits a crime. We cannot imagine any plausible examples, however.

High-stakes testing has led to some flagrant cases of outright cheating—for example, falsifying students' test scores. Given the nature of pertinent administrative data, recidivism projects seem relatively immune from cheating.[98]

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94 For New York, the number of "bed days," which is equal to the sum of (1) the number of days a person spends in jail or prison between initial release from prison and the end of the relevant observation period, and (2) if a person is in prison at the end of the observation period, the number of days remaining in his sentence, capped at 5 years from the date of his first release. CEO, Investing in What Works. Retrieved February 25, 2019, from https://www.payforsuccess.org/sites/default/files/resource-files/pfsprojectsummary_0314.pdf.

95 Roca's contract with Massachusetts excluded certain types of offenders that it believed could not benefit from cognitive behavioral therapy.

96 J. Booher-Jennings. (2005). "Below the Bubble: 'Educational Triage' and the Texas Accountability System," *American Educational Research Journal* 42(2), pp. 231–268. Retrieved February 12, 2019, from http://www.jstor.org/stable/3699376.

97 Moreover, although the nature of the offense, previous convictions, and demographic data may help predict recidivism, these data are unlikely to have the same predictive power as a student's academic record.

98 It's worth noting that a PFS contract in which an all-or-nothing payment to the service provider was based on meeting some threshold would create a strong incentive to cheat if the provider's outcomes were just beneath that threshold. (For whatever reason, the Peterborough recidivism project (see page 88) had this characteristic—though

Job Placement

The Massachusetts (MAJJ) and New York State (CEO) recidivism programs also include payments for job placement, which can be thought of either as a valuable outcome independent of reduced recidivism, or as an intermediate outcome that is likely to reduce recidivism (though not a strong proxy, as employed ex-offenders often re-offend). The MAJJ metric is based on "each quarter that a Roca participant is employed as compared to similar young men who are not in the program."[99] The CEO metric is a "binary indication of positive earnings in the fourth quarter following release from prison."[100]

As we mentioned above, depending on how participants are selected, job training programs are susceptible to strategic behavior. In the Oklahoma Milestones program described above, the service providers could choose their clients; the result was some creaming by choosing those most likely to succeed. Job placement programs might also be vulnerable to strategic behavior, such as achieving stable employment by placing clients in relatively non-demanding dead-end jobs. The MAJJ and CEO projects were designed to reduce the possibilities for strategic behavior of these sorts.

Job Readiness/Transitional Jobs

The MAJJ and CEO programs also compensate service providers for job-readiness training and placement in transitional jobs. For example, under MAJJ, Roca receives payments for increases in job readiness for each participant in each quarter that a participant engages with a Roca youth worker nine or more times. CEO is compensated for the number of clients who start a CEO transitional job during the relevant observation period.[101] These are early steps on the path toward stable jobs. Especially because placement in transitional jobs is entirely within CEO's control, the metric is vulnerable to some forms of strategic behavior.

Paying a provider for job readiness and transitional jobs is pretty far removed from the concept of PFS. Rather, including these criteria in a job placement or recidivism project is a means for giving a provider working capital as it seeks to meet more ambitious outcome requirements.

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there are no indications of attempted cheating. Subsequent PFS projects have paid the service providers incrementally for each successful participant.)

[99] Kodali, Grossman, & Overholser. (2014, p. 10).

[100] State of New York, Center for Employment Opportunities, & Social Finance. (2014, p. 10).

[101] "Transitional jobs are a critical step in the process of achieving employment and avoiding recidivism, according to the intervention's theory of change. This metric also captures the real financial value that the work performed in transitional jobs creates for the public sector." Id.

Mental Health

The Santa Clara County mental health PFS project meets most of the criteria set out above. The purpose of the project is to reduce the county's emergency services for acutely mentally ill patients; the outcome metric is reduction in use of high-cost services. The county keeps accurate administrative data on utilization, both for its own purposes and for accounting to Medi-Cal. (The county's liability for Medi-Cal fraud far exceeds any benefits it could gain by cheating.) The most apparent way that the provider, Telecare, could engage in strategic behavior would be to prevent its clients from making use of the county's emergency services without providing them with equivalent services. To avoid this potential problem and to learn from the program, the program's evaluator is charged with monitoring the quality of Telecare's care for its clients.

Homelessness

The most complex metric for the Santa Clara County homelessness project is whether a participant is in "continuous tenancy." The contract defines this term in considerable detail, making allowances for absences for various reasons, including emergency psychiatric care and incarceration.[102] The county does not collect administrative data on occupancy of permanent supportive housing as a matter of course, however, and the provider has considerable control over the reporting.

Early Childhood Education

There is evidence that early childhood education can reduce at-risk children's needs for special education and increase academic achievement.[103] Most school districts have reliable administrative data indicating whether children are in special education classes. The main vulnerabilities of early childhood PFS projects involve the specification and administration of outcome metrics. In the Utah program, the need for special education was determined by the Peabody Picture Vocabulary Test (PPVT), which some experts thought led to an exaggerated number of children diagnosed as at-risk and therefore too low a bar for success.[104]

Improving Outcomes for Disadvantaged New Mothers and Their Children

The South Carolina Nurse-Family Partnership (NFP) PFS program was launched in 2016 with the goals of "reducing preterm births; decreasing child hospitalization and emergency department usage due to injury; improving healthy spacing between births; and increasing the number of first-

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102 Santa Clara County, *Project Welcome Home - FAQ*. Retrieved February 25, 2019, from https://www.sccgov.org/sites/opa/nr/Documents/FINAL%20-150814_SCC%20CH%20PFS_FAQ_vFinal.pdf.

103 W. S. Barnett. (1995). "Long-Term Effects of Early Childhood Programs on Cognitive and School Outcomes," *The Future of Children*, 5(3), pp. 25–50. Retrieved February 12, 2019, from https://doi.org/10.2307/1602366.

104 https://www.nytimes.com/2015/11/04/business/dealbook/did-goldman-make-the-grade.html.

time mothers served in the lowest-income communities."[105] Prior RCT evaluations of several very similar programs gave the parties to the South Carolina contract reasonable confidence that it would produce the agreed outcomes. Payments are based on a contemporaneous RCT. Much of the outcome data is based on surveys.

The Service Provider's Perspective

Predicting the Service Provider's Effectiveness

As we mentioned above, service providers must be able to predict the program's costs with reasonable certainty. Their main challenges lie in predicting how *effective* the program will be—that is, how many clients must be treated at what cost to achieve a single successful outcome. A robust evaluation of a prior similar program can reduce, but not entirely eliminate, the margin of error. Significantly overestimating the program's effectiveness could lead to the service provider's insolvency—or require the organization to beg for relief from the government or philanthropic funders. This uncertainty creates a degree of risk for the service provider, who may reasonably respond by demanding a higher payment per outcome, or a graduated payment scheme that moves the program out of the red with early indications of success.

Therefore, before entering into a PFS contract, the parties will endeavor to predict the service provider's success rate—a probability distribution centered on the best estimate.[106] Returning to our example of a teen pregnancy prevention program, the provider's best estimate may be that 7 percent of the girls in the program become pregnant, but there's some probability that none of them do (total success) or that 20 percent or more become pregnant (total failure or worse). The prediction will be based on past experience with similar programs.

Under a PFS program with payment based on impact (rather than merely outcomes), the parties must predict not only the actual program outcomes but how they will compare with the counterfactual (what would have happened in the absence of the program).

The most robust prediction would be based on well-designed and well-conducted evaluations of one or more very similar prior programs—evaluations based on RCTs that compare the outcomes for people served by the program to a similar group of people who were not served. In the

105 South Carolina - Healthy Connections Medicaid. Fact Sheet: South Carolina Nurse-Family Partnership Pay for Success Project. Retrieved February 12, 2019, from https://www.scdhhs.gov/sites/default/files/2-16-16-SC-NFP-PFS-Fact-Sheet_3.pdf and Coalition for Evidence-Based Policy. (2014, p. 2).

106 The prediction is important not only to the provider, but also to the government, which does not wish to incur the transaction costs and reputational costs of a failed program.

Massachusetts Juvenile Justice project, New York State recidivism project, and Nurse-Family Partnership project, for example, the service providers had conducted prior programs with evaluation that provided reasonably good evidence of the success of interventions. In the absence of a prior evaluation, the parties must rely on weaker evidence of the service provider's or others' interventions. This was true of the Peterborough and Riker's Island recidivism programs and the Santa Clara County homelessness and mental health programs.

Predicting the Service Provider's Costs

Let's suppose that, based on its own or others' past experience, the service provider estimates the cost of the teen pregnancy prevention program at $2,500 per client, which, of course, includes counseling the girls with whom it does *not* succeed and the many who would not have become pregnant anyway. We'll assume that the provider's program typically involves 100 girls per year.

So far, we also have assumed that:

- The government is willing to pay at least $35,000 per pregnancy avoided.
- The base rate of teen pregnancies for the target population is 20 percent.
- The service provider's best estimate of its effectiveness is that it can reduce the rate to 7 percent.
- It costs the service provider $2,500 per participant in its teen pregnancy prevention program, or $250,000 for a cohort of 100 girls.

The payer would not pay the service provider anything if 20 or more participants got pregnant. Between 20 and 0 pregnancies, it offers to pay $35,000 x (20 *minus* number of pregnancies),with the service provider receiving a maximum of $700,000.

The table on the next page shows the service provider's net profit or loss for various outcomes in treating a cohort of 100 girls. It will break even if 12 girls become pregnant and will lose if more than 12 do. It is apparent that the parties' estimation of the likely outcome is a crucial factor in determining the terms of a PFS contract.

Payment Based on Impact vs. Outcomes

The methods for evaluating success as a basis for paying the provider may be more or less accurate and more or less costly, and there generally is a tradeoff between accuracy and cost. There are essentially two ways to establish a benchmark for payments under a PFS project:

- An *evaluation* that compares outcomes for the provider's clients with those of a similar group who did not participate in the provider's program

- a successful outcome. The payment rate is based on the government's estimate of the cost savings or on the individual or social benefits for each successful outcome.

Pregnancies	Cost	Payment Calculation	Payment	Profit/Loss	Impact: Pregnancies Avoided
0	$250,000	20 x $35,000	$700,000	$450,000	20
1	$250,000	19 x $35,000	$665,000	$415,000	19
2	$250,000	18 x $35,000	$630,000	$380,000	18
3	$250,000	17 x $35,000	$595,000	$345,000	17
4	$250,000	16 x $35,000	$560,000	$310,000	16
5	$250,000	15 x $35,000	$525,000	$275,000	15
6	$250,000	14 x $35,000	$490,000	$240,000	14
7	$250,000	13 x $35,000	$455,000	$205,000	13
8	$250,000	12 x $35,000	$420,000	$170,000	12
9	$250,000	11 x $35,000	$385,000	$135,000	11
10	$250,000	10 x $35,000	$350,000	$100,000	10
11	$250,000	9 x $35,000	$315,000	$65,000	9
12	$250,000	8 x $35,000	$280,000	$30,000	8
13	$250,000	7 x $35,000	$245,000	($5,000)	7
14	$250,000	6 x $35,000	$210,000	($40,000)	6
15	$250,000	5 x $35,000	$175,000	($75,000)	5
16	$250,000	4 x $35,000	$140,000	($110,000)	4
17	$250,000	3 x $35,000	$105,000	($145,000)	3
18	$250,000	2 x $35,000	$70,000	($180,000)	2
19	$250,000	1 x $35,000	$35,000	($215,000)	1
20	$250,000	0 x $35,000	$0	($250,000)	0
21	$250,000	1 x $35,000	($35,000)	($285,000)	-1
22	$250,000	2 x $35,000	($70,000)	($320,000)	-2
23	$250,000	3 x $35,000	($105,000)	($355,000)	-3
24	$250,000	4 x $35,000	($140,000)	($390,000)	-4
25	$250,000	5 x $35,000	($175,000)	($425,000)	-5
26	$250,000	6 x $35,000	($210,000)	($460,000)	-6

Table 3. Net profit or loss for service provider in hypothetical project to reduce teen pregnancy.

- An *evaluation* that compares outcomes for the provider's clients with those of a similar group who did not participate in the provider's program
- A "*rate card*," in which the provider is paid a specified amount for each client who achieves a successful outcome. The payment rate is based on the government's estimate of the cost savings or on the individual or social benefits for each successful outcome.

Evaluation

The surest way to measure a program's success is to build a contemporaneous evaluation into the program. The basic strategy underlying an evaluation is to compare the average outcomes of participants in the program (the "treatment group") with the average outcomes of similar people who do not participate—those who receive whatever services the government would ordinarily provide (the "control" or "comparison" group). If the average outcomes of the treatment group are better, there are standard techniques for assessing whether the difference is statistically significant (rather than simply different by random chance). *How much better* the outcomes need to be for what amount of payment is initially the government's decision, and then the subject of negotiation among the parties—issues that we have discussed above.

The gold standard for an evaluation of program outcomes is a randomized controlled trial (RCT), in which potential clients of the program are randomly assigned either (1) to the program (treatment group) or (2) to a control or comparison group that receives whatever services the government would ordinarily provide—and the outcomes of the two groups are compared.

An RCT is called an *experimental* technique. Evaluation also can be done through *quasi-experimental* techniques, in which the comparison group is created by selecting people who seem similar to those in the treatment group. The weakness of quasi-experimental techniques is that the experimenter may miss some salient characteristics used to match the groups, whereas a properly done RCT takes account of all of these characteristics. Another technique involves a comparison with a similar population at an earlier time. In addition to the weaknesses just mentioned, a pre/post evaluation may not account for changes in the external environment over time that would lead to the apparent success (or failure) of the program. In the Santa Clara County mental health and homelessness PFS projects, for example, perhaps changes in the economy, including the cost and availability of housing, make it difficult to generalize from one period of time to another. These questions must be considered one PFS project at a time [107]

Evaluations are costly and time consuming, and there is ample potential for errors.[108] But when done well, they not only provide an accurate basis for payment, but develop knowledge about a program's impact that can be useful beyond the particular project to others interested in achieving good outcomes for similar populations.

Many of the PFS programs described in Part II determine success payments on the basis of evaluations using experimental or quasi-experimental methods.[109]

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[107] Rather than discussing evaluation techniques at greater length here, we put a reference in a footnote. An excellent (and free) book is Paul Gertler et al., *Impact Evaluation in Practice* (2nd ed. World Bank, 2016). Retrieved February 20, 2019, fromhttps://openknowledge.worldbank.org/handle/10986/25030.

[108] A. Deaton & N. Cartwright (2016). *Understanding and Misunderstanding Randomized Controlled Trials* (No. 22595). Cambridge, MA: National Bureau of Economic Research. Retrieved February 12, 2019, from http://www.nber.org/papers/w22595.pdf.

[109] K. A. Walsh, R.TeKolste, B. Holston, & J. K. Roman. (2016). *An Introduction to Evaluation Designs in Pay for Success Projects*. Washington, DC. Retrieved February 10, 2019, from

Rate Cards

In a number of PFS projects, the parties have based payments on outcomes alone, without evidence of causality, or impact.[110] Outcome rate cards are a prime example. Also known as benchmark design, rate cards have been used in performance-oriented programs in the United Kingdom and United States. With a rate card, the government payer defines:

- the target group of beneficiaries
- the outcomes it wishes to achieve
- the price per outcome it is willing to pay.

Rate cards do not require any contemporary evaluation. Rather, they compare a program's outcome against a predetermined baseline or benchmark. Rate cards are simpler and less expensive to use, and payment determinations can be made more quickly. They are less risky for service providers and investors because they don't require demonstrating that the intervention contributed to the outcome.[111] Eliminating the requirement of attribution allows a PFS program to have multiple service providers, each of which can work with the same target population as long as each has identifiable clients.

But rate cards come with significant limitations as well. The absence of a comparison group limits the government's ability to determine whether the outcomes were caused by the intervention or by other factors. To the extent the outcome would have occurred even in the absence of the program, the government wastes its money. And whereas each experimental evaluation contributes knowledge about the value of an intervention, rate cards make no such contribution.

Another potential risk connected with rate cards is that if service providers can independently choose whom to serve, they might cherry-pick clients who are most likely to have successful outcomes. One solution is to offer higher rates for services to populations that are harder to serve.[112] Another is to assign participants randomly to service providers. (Even if a service

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http://www.urban.org/sites/default/files/publication/83931/2000913-an-introduction-to-evaluation-designs-in-pay-for-success-projects.pdf.

110 E. Gustafsson-Wright & S. Gardiner. (2015). *Policy Recommendations for the Applications of Impact Bonds*. Washington, DC. Retrieved February 12, 2019, from https://www.brookings.edu/wp-content/uploads/2016/07/SIB20Policy20Brief201web-1.pdf.

111 M. Eldridge. (May 23, 2016). *How the U.K. Pays for Success*. Retrieved June 27, 2017, from http://pfs.urban.org/pay-success/pfs-perspectives/how-uk-pays-success.

112 J. Grossman & K. Tan. (January 12, 2016). *What Can the Australian Job Services System Teach Us About Pay for Success?* Retrieved June 27, 2017, from marketplace; Social Finance. (2016a). *Outcomes Rate Cards: Frequently Asked Questions*. Retrieved February 12, 2019, from http://socialfinance.org/content/uploads/OutcomesRateCard_FAQ.pdf.

provider is unable to cream the whole pool, however, it could still potentially identify those within their assigned group and focus its efforts for the highest possible payout.)

Most PFS projects in the United States incorporate experimental evaluation methods, but rate cards or their equivalents are increasingly being used:

- Utah School Readiness Initiative, described above, in which payments are based on the number of children not needing special education each year.
- Santa Clara County Project Welcome Home, in which payments are based on the number of months of continuous tenancy per participant. (An RCT companion study was used to assess the program's efficacy, but not for payment.) The Massachusetts Chronic Individual Homelessness PFS project uses a similar payment scheme.
- Santa Clara County Partners in Wellness Project, in which payments are based on reduction in the use of emergency and inpatient psychiatric services by the people in the beneficiary population compared to historic use. (As in the Santa Clara County homelessness project, an RCT companion study was used to assess the program's efficacy, but not for payment.)

As in any before/after evaluation, the more confident one can be that the external environment has not changed in important ways, the more confidently one can rely on the prior benchmark without the need for a contemporaneous evaluation.

In sum, rate cards can reduce the cost of PFS programs, but at the expense of learning whether a program actually causes its intended outcomes. We imagine that rate cards are most valuable in situations where there have already been robust evaluations of a program and social scientists are reasonably confident in their generalizability. Even then, knowledge about the efficacy of programs will depend on repeated experimental evaluation from time to time. In 2016, the Corporation for National and Community Service awarded $1.44 million to Social Finance to introduce outcome rate cards in the United States.[113]

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[113] Corporation for National and Community Service. (November 3, 2016). Federal Agency Announces $13 Million in Funding to Support Pay for Success Projects. Retrieved June 27, 2017, from https://www.nationalservice.gov/newsroom/press-releases/2016/federal-agency-announces-13-million-funding-support-pay-success.

Data and Organizational Challenges to an Outcomes-Oriented Approach

The General Problem

In 1993, during the Clinton administration, Congress enacted the Government Performance and Results Act (GPRA) with the goal of fostering effective performance management practices within federal government agencies. Among other things, the GPRA required agencies to publish strategic plans and annual performance plans and reports. As it turned out, however, few agencies examined performance data or evaluation findings.[114]

Two decades later, the Obama administration sought to foster improved program outcomes through the GPRA Modernization Act of 2010, which required agencies to set goals, including goals for cross-agency collaborations, and to establish evaluation mechanisms to report the performance and outcomes of each program and make revisions as needed. The Act recognized the need for innovation and testing to discover better practices.[115]

Despite improvements over these decades, many federal agencies still fall far short of developing strategies and using data to achieve effective program outcomes.[116] With a few noteworthy exceptions, state and local government agencies have done no better.

In his important article "Using Data to Make More Rapid Progress in Addressing Difficult U.S. Social Problems," Jeffrey Liebman, director of the Harvard Kennedy School's Government Performance Lab (GPL), uses the example of a program to reduce infant mortality to describe four types of data analysis necessary for effective social interventions by government agencies:

- The agency must analyze infant deaths and low-birth-weight babies to identify the entire target population (rather than only those who show up at the agency's front door) and formulate hypotheses about policy interventions that could potentially ameliorate or solve the problem.

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114 Shelley Metzenbaum & Robert Shea. (2016). *Performance Accountability, Evidence, and Improvement*. PDF. National Academy of Public Administration and Volcker Alliance Inc., October 2016, p. 4.

115 Ibid., (2016, pp. 5–7).

116 Ibid., (2016, p. 7).

- The agency must use data on risk levels and intervention cost effectiveness for specific subpopulations to refer the right people to the right services (e.g., high- or low-intensity home visiting; public health campaigns around nutrition, exercise, and healthy infant sleep; drug treatment programs; and teen pregnancy prevention programs).
- The agency must monitor the delivery of services in real time and collaborate with service providers to minimize the portion of the target population that fails to receive the services.
- The agency must periodically compare outcomes for people referred to different services to determine how to allocate resources and adjust referral protocols going forward.

Liebman concludes that the main barriers to using data to improve government agencies' outcomes are the absence of leadership willing to undertake change based on data, lack of staff with the expertise and capacity to lead data-driven projects, and lack of the software and hardware infrastructure to manage data. These challenges are exacerbated by insular organizational cultures, legal restrictions on sharing data, and non-interoperable databases.

This section reviews the barriers to collecting and using data to design, manage, and improve social programs and suggests how they can be overcome. We should note that a number of the PFS programs described in Part Two have been quite successful in this regard. Recall that Cuyahoga County, Ohio, realized that the common beneficiaries of various social programs were not being effectively served by disconnected government services and developed an integrated data system as part of its program to address their problems.

The operations of Cuyahoga County's agencies serving homeless families and families with children placed in foster care had not previously been integrated to identify families who were experiencing homelessness in either way. The Center on Urban Poverty and Community Development at Case Western's School of Applied Social Sciences used the ChildHood Integrated Longitudinal Data System (CHILD), which connects data from 18 systems and stores more than 500,000 records of children living in Cuyahoga County.[117] This integrated data system enabled the PFS project to identify the beneficiary population, quantify the children's time in foster care, and design an intervention that met the specific needs of the children and parents.

Categories of Data

Government agencies providing social services need data to inform a program's design and development and to monitor and evaluate its implementation. Designing the program calls for combining evidence about similar programs in other places with data about one's own population. Monitoring the program's implementation requires data specific to the population being served.

117 Center on Urban Poverty and Community Development. (2019). "CHILD System." Retrieved February 14, 2019, from http://povertycenter.case.edu/data-systems/child-data-system/.

Once a PFS contract is in place, both the government and the service provider need ongoing data to monitor, improve, and ultimately evaluate performance and determine payments based on it.[118]

For our purposes, there are two important categories of data: administrative and survey data. Administrative data is collected by agencies or their contractors in the ordinary course of performing their work. To use familiar examples, a department of motor vehicles has data concerning people who hold drivers' licenses; a department of corrections has data on people who are incarcerated; a school or college has data about enrolled students and their grades. These groups may have various information about their clients or other stakeholders, such as their ages, certain physical characteristics, social security numbers, and addresses. Some agencies are more meticulous than others in ensuring the accuracy of administrative data. All things considered, the more salient the data is to the agency's function, the more likely it is to be accurate. Administrative data have been vital to the evaluation of anti-recidivism, education, and other social programs.

Survey data is collected either for statistical purposes—in the original sense of statistics, meaning information relevant to the state—or to gather information about particular programs. The US Census is an example of the former, as is the European Union's Eurostat database, which includes data about population and social conditions, economics and finance, industry, trade, and agriculture.[119]

The monitoring and evaluation of social programs often requires survey data that is collected specifically for programmatic purposes. For example, in the case of Santa Clara County's mental health PFS program, whereas information about patients' hospitalization is administrative, the assessment of their physical and psychological well-being is based on surveys. One cannot generalize about the relative validity and reliability of one form of data compared to the other. Because the collection of administrative data is likely to be already included in an agency's budget, however, survey data often adds incremental costs to a project.

Whatever the nature of the data, PFS projects often require aggregating and analyzing data from various sources. There are three barriers to doing this: (1) legal restrictions on sharing data, (2) agencies' siloed cultures, and (3) non-interoperable databases.

Legal Restrictions

Out of concern for clients' privacy, regulations often prohibit agencies from sharing certain data with other agencies, researchers, or non-governmental organizations. Some of these prohibitions are embedded in long-standing statutes that have not been updated to reflect contemporary needs and data-analytic techniques. Unclear regulations tend to be interpreted conservatively to disallow

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118 Office of Management and Budget. (2016).

119 Eurostat. Retrieved November 7, 2019, from http://ec.europa.eu/eurostat.

data sharing.[120] The Family Educational Rights and Privacy Act (FERPA) has long vexed colleges, governments, and researchers who need access to student records for research purposes. In the absence of clear guidelines about how such data may permissibly be shared and used, most organizations take a conservative approach. Nonetheless, many state laws and regulations permit sharing specific government data among government entities and organizations contracting with them.[121]

Researchers often need personally identifiable information to aggregate data from multiple datasets. The individual information often can then be redacted to protect privacy. But in their concern for privacy, many regulations prevent sharing information without considering the possibility of redaction.[122] In general, when federal and state regulations permit confidential data to be used for research, the researchers must describe how the data will be protected from any unauthorized disclosure. In many cases the law requires a formal contract or interagency agreement between the research institution and the agency.[123]

Sharing health data is important for treating patients and for epidemiological purposes. The federal Health Insurance Portability and Accountability Act (HIPAA), which governs confidentiality of patients' medical information, does not specify how medical information may be used and disclosed by government health agencies.[124] The Department of Health and Human Services

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120 Office of Management and Budget. (2016).

121 Several states, including Iowa, Minnesota, and California, identify organizations that are exempt from data sharing restrictions by data user category or name. K. Poole & H. Springer. (2015). *Balancing Confidentiality and Access: Sharing Employment and Wage Data for Policy Analysis and Research*. Center for Regional Economic Competitiveness. Retrieved February 12, 2019, from http://www.lmiontheweb.org/download/2015-05/Report--_Data_Confidentiality_and_Sharing_-_CREC-LMI_Institute_-_May_2015.pdf.

122 National Research Council. (2001). *Studies of Welfare Populations: Data Collection and Research Issues*. Washington, DC: The National Academies Press. Retrieved February 12, 2019, from https://doi.org/10.17226/10206.

123 National Research Council. (2001).

124 Section 264 of the HIPAA provides that the Secretary of Health and Human Services shall submit to the Senate and the House of Representatives recommendations on the standards for protection of privacy of individually identifiable health information, addressing rights, procedures, and authorized uses and disclosures of such information. Such legislation should have been enacted within 36 months after the enactment of the HIPAA. In its absence, the Department of Health and Human Services published the Privacy Rule on December 28, 2000, but the HIPAA provides that such regulation may not supersede a contrary provision of state law if the latter imposes requirements, standards, or implementation procedures that are more stringent than the regulation itself. As a result, state and local laws, as well as agencies' policies, establish the procedures for the use, maintenance, and disclosure of a patient's disease information.

Privacy Rule, published on December 28, 2000, provides that federal regulations may not supersede more stringent requirements required by state laws.

State and local laws therefore are important in determining the procedures for the use, maintenance, and disclosure of a patient's disease information. For example, the health data of patients in New York City is regulated by the New York State Public Health Law, the New York State Sanitary Code, and the New York City Health Code. The resulting patchwork of regulations can impede data sharing even among programs and government agencies in the same state. For example, the New York State Public Health Law provided that HIV-related information could be disclosed only through a written and signed authorization from the patient or for medical treatment purposes. In 2010, the New York State legislature amended the Public Health Law to allow HIV-related information to be used for additional purposes, including service delivery program needs. New York City health departments developed the necessary infrastructure to share and integrate public health data among health departments.[125]

Siloed Operations and Lack of Database Interoperability

Government agencies often operate in silos. Data collected from their targeted beneficiaries often is not shared with other agencies and service providers even when permitted by regulations,[126] and agencies often do not ask social service providers for data necessary to identify target populations, measure outcomes, and manage operations.[127] Necessary capacities for useful data sharing include[128]

- The administrative infrastructure to manage data-access requests and develop and implement data sharing agreements.
- Data management and curation infrastructure to make the data useful for evidence-building activities.
- Information technology to meet operability and data security needs.

M. Rose Gasner, Jennifer Fuld, Ann Drobnik, & Jay K. Varma. (2014). *American Journal of Public Health* 104(6): 993–997. Published online June 2014. doi: 10.2105/AJPH.2013.301775. Retrieved February 14, 2019, from https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4062019/.

125 Id.

126 The Annie E. Casey Foundation. (2017). *Improving Child and Family Service Through Integrated Data Systems*. Baltimore, MD. Retrieved February 15, 2019, from http://www.aecf.org/blog/improving-child-and-family-services-through-integrated-data-systems/.

127 Harvard Kennedy School Government Performance Lab, *Active Contract Management: How Governments Can Collaborate More Effectively with Social Service Providers to Achieve Better Results*. Retrieved January 30, 2019, from https://govlab.hks.harvard.edu/files/siblab/files/acm_policy_brief.pdf.

128 The Office of Management and Budget. (2016).

- Infrastructure to ensure privacy and confidentiality.
- Hardware and software for data analysis.
- The technical capacity for analyzing the data gathered.

Even when the right data is collected, many government agencies lack staff capable of reviewing data to identify best practices and drive operational or practice reforms and improvements.

A possible solution to some of these problems is to designate certain agencies as hubs to use the infrastructure already in place for this purpose.[129] For example, the Census Bureau has the technical and policy infrastructure necessary to oversee large, multilayered datasets and has experience in providing access to researchers through the Federal Statistical Research Data Centers.

Organizational Challenges, and the Need for Active Contract Management

The Harvard Kennedy School's Government Performance Lab (GPL) published a study assessing how government agencies could collaborate more effectively with service providers to improve outcomes for their clients.[130] The study identified a passive stance toward contract management as a major barrier. Contract management typically is performed by an agency's back office, which often focuses on invoicing and compliance rather than actively monitoring and working with a service provider to achieve the expected results. Not surprisingly, service providers rarely receive information comparing their performance to that of other providers, thus limiting opportunities to identify and replicate best practices.

To overcome these organizational problems, the GPL proposes a set of strategies termed "active contract management," which call for changes in the internal organization, culture, and operation of both government agencies and service providers, and changes in their relationships with each other. Under active contract management, the parties select appropriate metrics and indicators for each program, share information and data through a joint management information system with a common database, and elevate the status of contract activities from back-office to senior staff responsible for working with service providers to improve outcomes.

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129 Id.

130 Harvard Kennedy School Government Performance Lab. (2019). Retrieved November *Active Contract Management: How Governments Can Collaborate More Effectively with Social Service Providers to Achieve Better Results.* Retrieved January 30, 2019, from https://govlab.hks.harvard.edu/files/siblab/files/acm_policy_brief.pdf.

The Role of Intermediaries and Technical Assistance Providers

The complexities of the PFS process, the number of stakeholders, and the necessary parties' frequent lack of requisite expertise have created a demand for third party organizations that provide technical assistance to governments and other stakeholders and coordinate their work. These intermediaries play an important role in three phases of a PFS program.

In an *exploratory phase*, the intermediary helps a government

- Identify intended social outcomes for a particular target population.
- Identify possible interventions to achieve the outcomes.
- Assess the feasibility of a project, i.e., the ability, willingness, and commitment of government agencies, service providers, and other stakeholders to participate successfully in the project.
- Assess the suitability and possibilities of PFS financing.
- Write and issue requests for proposals.
- Select a service provider.

If the potential project seems promising, it proceeds to the *development phase*, where the intermediary helps

- Determine social and financial outcomes and set specific project goals.
- Define how to measure the outcomes.
- Develop a payment model and a contract structure.
- Develop a work plan and design the project's financial structure.
- Estimate the total funding needed for the project and assess its financing needs
- Identify funders and engage in fundraising.
- Negotiate contracts with the stakeholders.
- Engage an independent evaluator to measure the outcomes and determine payment.

In the third phase, once the project is launched, the intermediary may assume an ongoing role in *project management* and oversight. The intermediary

- Monitors progress.
- Ensures that the project is on track and recommends necessary corrective measures.
- Ensures that evaluation findings and other information are shared among the stakeholders.
- Prvides accounting and analytic support.

Throughout the second and third phases, the intermediary mediates among the stakeholders involved, who often have differing interests.[131]

The preceding delineation of the intermediary's functions is based on self-descriptions of two leading intermediaries in the United States: Third Sector and Social Finance.

Third Sector, based in Boston, is a nonprofit advisory firm founded in 2010 by George Overholser and Caroline Whistler. Third Sector's stated mission is to "accelerate the transition to a performance-driven social sector" by "collaborating deeply with communities to re-write how they contract for social services, re-aligning vast amounts of public resources to move the needle on social problems."[132] Social Finance, also based in Boston, is a nonprofit organization that supports PFS financing in the United States. It was founded in 2011 by David Blood, Sir Ronald Cohen, and Tracy Palandjian, mirroring its British sister organization, Social Finance UK, which pioneered PFS financing in England. Social Finance's mission is to "mobiliz[e] capital to drive social progress."[133]

Although Third Sector and Social Finance engage in similar activities, Third Sector acts in an advisory capacity, typically at the behest of the government entity that will ultimately pay for performance, whereas Social Finance assumes direct responsibility for managing the PFS project before and after its launch.

There is one prominent global intermediary outside the United States. Instiglio is a nonprofit organization founded in Bogota, Colombia, in 2012 by three Kennedy School alumni, Michael Belinsky, Michael Eddy, and Avnish Gungadurdoss. Its goal is to alleviate poverty in developing countries by using instruments that tie funding to measurable results and impact. Since its creation, Instiglio has launched PFS projects in the Americas, Asia, Africa, and the Middle East. Its target issues include education, conservation, workforce development, and market building.[134]

These three organizations are almost exclusively focused on PFS or (to use Instiglio's term, which is common outside the U.S.) results-based financing (RBF). Several other organizations with broader mandates have become more active in PFS.

The Government Performance Lab (GPL) at Harvard's Kennedy School of Government is the successor to the Kennedy School's SIB Lab, founded in 2011. Its goal is to improve the

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131 Kodali, Grossman, & Overholser. (2015).

132 Third Sector Capital Partners. Mission and Values. Retrieved February 15, 2019, from https://www.thirdsectorcap.org/mission/

133 Social Finance webpage. Retrieved February 15, 2019, from http://socialfinance.org/.

134 Instiglio webpage. Retrieved February 15, 2019, from http://www.instiglio.org/en/.

effectiveness of state and local government funding of social projects by promoting an outcomes orientation and improved data management technology.[135] The GPL holds competitions in which government groups are invited to submit applications to receive pro bono technical assistance to implement PFS and other projects. Winners receive the support of Government Innovation Fellows, who serve as their advisors on the project for one year. The GPL has helped numerous government agencies implement active performance management (described in the preceding section).[136] In addition to providing technical assistance, GPL sometimes acts as an intermediary in PFS programs, providing services similar to those of Social Finance and Third Sector.

The Nonprofit Finance Fund, founded in 1980 by Clara Miller, helps organizations achieve their social goals by providing a range of advisory and financing services to nonprofits and funders.[137] NFF, whose main activities involve raising capital from banks, foundations, and governments to make loans to nonprofits, has expanded its work to provide technical assistance for PFS projects.

Since 2014, the Sorenson Impact Center at the University of Utah David Eccles School of Business has provided technical assistance and PFS fellows to numerous government agencies and organizations.[138]

Several other technical assistance providers focus on particular subject areas. For example, the Institute for Child Success offers technical assistance to prospective projects in early childhood health, welfare, and education[139]; the Green and Healthy Homes Initiative helps develop projects that address asthma[140]; and the Corporation for Supportive Housing focuses on homelessness (CSH, 2017).[141]

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135 Harvard Kennedy School Government Performance Lab webpage. Retrieved February 15, 2019, from https://govlab.hks.harvard.edu/home.

136 Harvard Kennedy School Government Performance Lab. Harvard Kennedy School Government Performance Lab. https://govlab.hks.harvard.edu/projects, Retrieved March 7, 2019.

137 Nonprofit Finance Fund webpage. Retrieved February 14, 2019, from http://www.nonprofitfinancefund.org.

138 https://sorensonimpact.com/

139 Institute for Child Success. (June 22, 2017). Pay for Success Technical Assistance Competition. Retrieved July 27, 2017, from http://pfs.instituteforchildsuccess.org/ta_competition/.

140 Green and Healthy Homes Initiative. (2017). Pay for Success. Retrieved July 27, 2017, from http://www.greenandhealthyhomes.org/get-help/pay-success.

141 Massachusetts Housing & Shelter Alliance, Corporation for Supportive Housing, & United Way of Massachusetts Bay and Merrimack Valley. (2017).

Funding and Appropriations

State and Local Budgets

Under a PFS project, the government commits to making payments a number of years later. The other parties need assurance that the government will actually pay. The committed funds can come either from a pre-existing budget authorization or from a new funding stream created for the specific purpose of PFS. Among the existing PFS projects in the United States, a few have been funded through carve-outs from existing budgets—essentially in the same way that governments commit to multi-year vendor relationshieps—and the majority from special state or local legislation.[142]

As an example of the funding through carve-outs from existing budget authorizations, the Board of Supervisors of Santa Clara County simply allocated the necessary funds from its regular budget to support the Project Welcome Home permanent supportive housing project. In a "nonbinding Memorandum of Understanding" signed by all of the main stakeholders, the county agreed to include up to $2 million in success payments during the first year of the project and to engage in a six-year PFS contract with the service provider, Abode.[143]

Special legislation has the advantage of assuring that the contract is within the government's authority and creating a formal guarantee of repayment if the terms of the contract are met. An analysis by Third Sector and the law firm Orrick, Herrington & Sutcliffe notes that "while states may enter into PFS contracts without specific legislative authorization, the lack of legislative support may limit the ability to attract funders and to corral relevant state actors."[144]

In July 2012, Massachusetts became the first state to enact special legislation of this sort. "An Act Establishing the Social Innovation Financing Trust Fund" created a financial trust "for the purpose of funding contracts to improve outcomes and lower costs for contracted government services, hereinafter referred to as 'pay for success contracts.'"[145] The law conditioned the payments on the achievement of outcomes based on evaluation and created a sinking fund that required regular

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142 P. Teicher, J. Grossman, & M. Chong. (2016). *Authorizing Pay for Success Projects: A Legislative Review and Model Pay for Success Legislation*. Retrieved February 20, 2019, from http://www.thirdsectorcap.org/wp-content/uploads/2016/03/Authorizing-Pay-for-Success-Projects-Legislative-Review.pdf.

143 http://sccgov.iqm2.com/Citizens/Detail_LegiFile.aspx?Frame=&MeetingID=6059&MediaPosition=&ID=77051&CssClass=

144 http://www.thirdsectorcap.org/wp-content/uploads/2016/03/Authorizing-Pay-for-Success-Projects-Legislative-Review.pdf

145 https://malegislature.gov/Laws/GeneralLaws/PartI/TitleII/Chapter10/Section35VV

appropriations. Since Massachusetts's lead, eleven jurisdictions have enacted similar PFS laws. Some, like Massachusetts, authorize contracting for a broad range of social services. Others are limited to particular social issues, such as criminal justice or pre-kindergarten or family support programs.

Many of the special PFS laws condition payment on cost savings. For example, the Arkansas "Pay for Success Act" requires that any PFS contract "will result in specific performance improvements and budgetary savings if the performance targets are achieved."[146] Texas HB 3014 requires that "the state agency and the Legislative Budget Board certify that the proposed contract is expected to result in significant performance improvements and significant budgetary savings for the state agency or agencies party to the contract if the performance targets are achieved."[147] Cuyahoga County, Ohio's, ordinance establishes a fund "for the purpose of funding contracts to improve outcomes and lower costs."[148] These authorizations would not encompass a PFS program that improved outcomes for its beneficiaries without creating budgetary savings.

Federal and Philanthropic Support

Several federal programs have supplemented a state or local government's own budget to pay for a successful PFS project:

- The White House Social Innovation Fund (SIF), a program of the Corporation for National and Community Service, supported community solutions through its SIF classic and SIF Pay for Success programs. $352 million in federal investments have been matched by $707 million in state and private sector commitments.[149]
- The Department of Housing and Urban Development issued an RFP with funding from the Department of Justice for uses of PFS to help previously incarcerated people obtain permanent supportive housing.
- The Department of Labor Workforce Innovation Fund awarded $24 million to support the anti-recidivism projects in New York State and Massachusetts. A stakeholder interviewed by the GAO said that the DOL grant "catalyzed the New York project, allowing them to

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146 J. SB 427: Criminal Justice Reform Act of 2015, Pub. L. No. SB472 (2015). Retrieved February 12, 2019, from https://capitol.texas.gov/tlodocs/84R/billtext/html/HB03014F.HTM

147 https://capitol.texas.gov/tlodocs/84R/analysis/html/HB03014;

148 https://payforsuccess.org/resource/county-council-cuyahoga-county-ohio-ordinance-no-o2014-0018.

149 Corporation for National and Community Service. Social Innovation Fund. Retrieved February 12, 2019, from https://www.nationalservice.gov/programs/social-innovation-fund.

fund outcome payments for the first cohort of 1,000 participants."[150] The DOL funding enabled the Massachusetts officials to increase the number of total participants.
- The South Carolina Nurse-Family Partnership Pay for Success Project is being funded significantly by Medicaid waivers.

In some projects, government funds have been supplemented by philanthropic funding. In the five-year Utah High Quality Preschool Program, United Way of Salt Lake County, paid for the first cohort of children through a grant.

The federal government and other funders have provided resources for technical assistance to help state and local governments navigate the PFS process:

- In addition to subsidizing PFS payments, the White House Social Innovation Fund (SIF) makes grants to intermediaries to provide technical assistance to state and local government agencies.[151] For example, SIF awarded the Institute of Child Success (ICS) $782,412 over two years to make sub-grants for youth development projects, which included technical assistance for the City of Evansville, Indiana, to assess whether PFS could expand access to quality preschool education; technical assistance to help the Children and Families Commission of Orange County, California, determine whether PFS financing could be used to reduce abuse and neglect for at-risk children and families; and technical assistance to the Sonoma County, California, Department of Health Services to assess the feasibility of this largely rural county's initiating PFS projects for universal Pre-K and an expansion of the Nurse-Family Partnership.[152]

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150 U.S. GAO. (2015, p. 59).

151 Corporation for National & Community Service. (2017).

152 Corporation for National and Community Service. (April 16, 2016). Grantee Information: Institute for Child Success. Retrieved August 16, 2016, from https://www.nationalservice.gov/programs/social-innovation-fund/pay-success/institute-child-success. More broadly, ICS and similar organizations have assisted political and community leaders in spearheading PFS projects. For example, with the support of the Duke Endowment and the Doris Duke Charitable Foundation, ICS convened a working group of government officials and funders to help "provide the political leadership needed for a new approach." M. Golden. (2014). *Climbing the Pay for Success Learning Curve: How a Working Group Helped South Carolina Understand and Prepare for PFS Financing*. Greenville, SC. Retrieved February 20, 2019, from https://www.instituteforchildsuccess.org/publication/climbing-pay-success-learning-curve-working-group-helped-south-carolina-understand-prepare-pfs-financing/

As part of the SIF's sub-grantee program, the University of Utah Policy Innovation Lab awards governments $75,000 toward the hiring of a full-time staff member. Corporation for National and Community Service. (April 20, 2016). Grantee Information: Sorenson Impact Center at the University of Utah. Retrieved June 29, 2017, from https://www.nationalservice.gov/programs/social-innovation-fund/pay-success/university-utah-policy-innovation-lab.

- The Corporation for National and Community Service Social Innovation Fund awarded $12 million to fund intermediaries to provide technical assistance to local PFS projects. As of January 2017, the intermediaries had made awards to a total of 48 state and local governments and nonprofit organizations.
- In 2016, the US Department of Education announced its first PFS awards for career and technical education and dual language programs for early learners. These include a $2 million grant to Social Finance, in partnership with Jobs for the Future, and a contract with the American Institutes for Research to determine how to use Pay for Success strategies for English learning.[153]
- Most recently, the Social Impact Partnerships to Pay for Results Act (SIPPRA), a provision of the Bipartisan Budget Act of 2018, authorizes $100 million for outcome payments, evaluation costs, and select feasibility studies for state and local governments implementing programs that produce defined and rigorously measured outcomes and cost savings.[154]

SOCIAL INNOVATION FINANCING

In a typical fee-for-service arrangement, a government agency contracts directly with a service provider, paying the organization more or less contemporaneously for services billed. A PFS program complicates this arrangement in several ways. First, it is far from certain that the program will actually achieve its agreed outcomes, thereby entitling the service provider to receive success payments. Second, determining outcomes is inevitably more complicated than assessing whether services were delivered. Third, measurable outcomes—for example, an ex-offender's having stable employment rather than returning to prison—often lag the provision of services by years.

In theory, a service provider might deal with the funding gap through its own reserves or by borrowing money from a bank. But the delays and uncertainties just mentioned are likely to strain an organization's resources and make it difficult to obtain a conventional loan.

This problem can be solved in three ways. First, the government may pay some portion of the organization's expenses under a conventional fee-for-services arrangement, withholding the remainder for proof of outcomes or paying a bonus for achieving specified outcomes. The

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153 The White House Office of the Press Secretary. (October 11, 2016). Fact Sheet: New Commitments Announced in Support of the My Brother's Keeper Initiative at ESPN Town Hall with President Obama at North Carolina A&T State University. Retrieved June 29, 2017, from https://obamawhitehouse.archives.gov/the-press-office/2016/10/11/fact-sheet-new-commitments-announced-support-my-brothers-keeper.

154 https://pfs.urban.org/get-started/issue-areas/content/social-impact-partnerships-pay-results-act-sippra; https://home.treasury.gov/system/files/226/SIPPRA-NOFA-Feb-22-2019-FINAL.pdf.

provisions for payment for job readiness and job placement in some recidivism contracts can be seen as compromises with a pure PFS program to provide the service provider with working capital.

Second, the government may pay the full amount in advance, but try to "claw back" as much as it can if the agreed outcomes are not achieved. Although clawbacks are theoretically possible, they are generally impracticable: the government may suffer reputational and political damage by going after a service provider who, in any event, may not have recoverable assets.

Third, the project may attract *social innovation financing*—typically a blend of philanthropic and commercial funding by third parties who front the necessary capital. The government commits to repay the loans with interest, to the extent that the service provider achieves the agreed outcomes. Under social innovation financing, it is the lender, rather than the service provider, that gets paid for the service provider's success. Although the service provider may have less financial incentive to produce outcomes, its mission, reputation, and long-term interest in continuing the program create strong safeguards against slacking. Neither the literature nor our private conversations with stakeholders hint at cases of this sort of strategic behavior.

Under social innovation financing, a typical *capital stack* for a PFS program comprises.

- Loans by commercial lenders, usually at the lower end of risk-adjusted market rates.
- Below-market loans from foundations (typically made through program-related Investments) or from high net worth individuals, which are repaid either to the donor or to a revolving fund for disbursement to other PFS programs.
- Pure grants from foundations or high net worth individuals.

COMMERCIAL LENDERS

Commercial investors may have a mix of motivations for investing in a PFS project. For banks such as Goldman Sachs and Bank of America Merrill Lynch, which have been among the most frequent commercial lenders, investments may

- Provide an appropriate risk-adjusted return.
- Make an intrinsically valuable social contribution.
- Fulfill obligations under the Community Reinvestment Act (CRA), which requires banks. to meet the credit needs of the communities they serve.
- Burnish their reputations.
- Offer a service to high net worth clients who wish to make social investments.

With respect to the last of these, Bank of America Merrill Lynch raised $13.5 million through a private placement offering for New York State's CEO recidivism project. Andy Sieg, head of the bank's Global Wealth and Retirement Solutions, noted,

> One of the most pronounced trends among our clients is for their investments to not only earn a return but also to help drive social change in their communities and in society. We're unlocking the potential for this type of investing, enabling clients to direct capital to programs and organizations proven to produce positive outcomes, and taking an important step toward a scalable new marketplace.[155]

Banks have considerable experience in evaluating potential borrowers and calculating risks and returns. Investments in PFS programs are quite different from the mainstream of banks' lending, however. When a bank considers an ordinary loan, it analyzes the company's organizational health and balance sheet and considers market conditions that could affect the company's bottom line and hence its ability to repay the loan. The bank has a standard vetting process based on decades of loans to companies of similar size, age, and industry. This knowledge keeps the transaction costs relatively low and the estimated risk and return within a small margin of error.

In contrast, when considering a PFS contract, the bank must estimate the likelihood of success by examining the service provider's effectiveness. It must review literature on the subject and determine whether the targets that trigger success payments are realistic for the service provider to achieve. The interest rate on most PFS loans is at the low end of commercial returns; 5 percent is typical. There are seven principal risk factors for a commercial lender:

- PFS lenders are not repaid unless the service provider achieves an agreed target defined in the contract.[156]
- The lender must accurately predict whether the intervention will achieve the target.
- Achieving the target depends on the service provider's effectiveness in fulfilling its mission, as well as external factors that could impede success.
- Except where payments are based on a rate card, the lender's determination is based on an evaluation plan that is subject to an intrinsic margin of error as well as human error.
- Repayments are capped at a specified success level.
- Repayments depend on the government's willingness to follow through on a commitment often made a number of years earlier by a different administration. (Not all PFS projects have ironclad protection against the risk of a government's not appropriating the funds.[157])

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155 Bank of America Newsroom. (December 30, 2013). *Bank of America Merrill Lynch Introduces Innovative Pay-for-Success Program in Partnership With New York State and Social Finance Inc.* Retrieved September 6, 2016, from http://newsroom.bankofamerica.com/press-releases/global-wealth-and-investment-management/bank-america-merrill-lynch-introduces-innovat.

156 For example, MAJJ requires a 40% reduction in days of incarceration for success payments.https://www.thirdsectorcap.org/wp-content/uploads/2015/02/TSCP_MAJJ-PFS-Project-Brief.pdf. .

157 Massachusetts is unique for establishing a social innovation trust fund with full backing by the Commonwealth, which applied to MAJJ. D. Archer-Rosenthal. (2016). *Pay for Success : The First Generation*.

- The bank has no easy means of protecting against the government's default.[158]

Commercial lenders can mitigate their risk by negotiating a low bar for performance. In the Utah preschool program, for example, a low bar led to incredibly high success rates. But too low a bar defeats the purpose of PFS and creates a reputational risk for the lender.

Somewhat akin to banks, Community Development Financial Institutions (CDFIs) are federally regulated, mission-driven, private financial institutions that create economic opportunity by providing financial services to low- and moderate-income individuals and communities.[159] CDFIs have traditionally invested in capital projects, such as affordable housing and community facilities, but they can also advance their mission through investments in PFS projects.[160] Their experience working on complex, multi-party deals across local governments, funders, and nonprofits positions CDFIs well to participate in PFS deals. One national CDFI, Reinvestment Fund, is a senior lender in PFS projects in Cuyahoga County, Ohio, and Santa Clara County, California. Reinvestment Fund has contributed both its expertise and funds to these projects.[161]

PHILANTHROPIES

Foundations and individual philanthropists are motivated by the desire to achieve particular social objectives consistent with their missions or to serve their local communities. In a few cases— the Laura and John Arnold Foundation (LJAF) is the most notable example—the philanthropic funder wishes to advance the practice of evidence-based interventions. Foundations can contribute to a PFS program's financing in various ways. They can

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158 As mentioned above, foundations have guaranteed a portion of the loans in several PFS programs, but this is not typical.

159 Office of the Comptroller of the Currency. (December 29, 2010). Community Development Financial Institution (CDFI) and Community Development (CD) Bank Resource Directory. Retrieved July 2, 2017, from https://www.occ.gov/topics/community-affairs/resource-directories/cd-bank-and-financial-institution/index-cd-bank-and-financial-institution.html.

160 S. Godeke & L. Resner. (2012). *Building a Healthy & Sustainable Social Impact Bond Market: The Investor Landscape*. Retrieved February 12, 2019, from https://www.missioninvestors.org/system/files/tools/social-impact-bond-investor-landscape-godeke-consulting-dec-2012.pdf.

161 Another CDFI IFF is serving as an intermediary in Chicago's early childhood education PFS program. IFF receives the loans from commercial and philanthropic investors and in turn disburses them to Chicago Public Schools, the service provider. It will also receive success payments from the City of Chicago and disburse them to investors. Federal Reserve Bank of St. Louis. (September 1, 2015). Engaging CDFIs in Pay for Success, Andy Rachlin (The Reinvestment Fund) and Joe Schmidt (IFF). 8 From the Eighth Podcast. Retrieved February 20, 2019,from https://www.stlouisfed.org/community-development/multimedia/8-from-the-eighth/engaging-cdfis-in-pay-for-success.

- Make outright grants. In this case, the success or failure of the PFS program has no financial consequences.
- Make so-called *recoverable grants* that mimic loans, so that any success payments will be ploughed back into this or other PFS programs.
- Make below market-rate loans in the form of program-related investments (PRIs), often as subordinate lenders who will be repaid after commercial lenders.
- Guarantee the loans of commercial investors with a commitment to backstop investors' losses up to an agreed amount if the program does not achieve its objectives.

For example, LJAF made grants to support the Massachusetts Juvenile Justice project and Santa Clara County's Project Welcome Home, and it made a PRI a junior investor in Denver's Housing to Health Initiative. Together with the Robin Hood Foundation, LJAF participated as a subordinate investor in Bank of America Merrill Lynch's offering for the New York State recidivism program. The Kresge Foundation made a $1.5 million subordinate loan for the Massachusetts recidivism project. Depending on the project's success, it will receive principal, 2% annual interest, and a success payment of $300,000. The Kresge Foundation also made a $300,000 grant directly to Roca, the service provider, to support program implementation.

Bloomberg Philanthropies' loan guarantee in the New York City recidivism project mitigated most of Goldman Sachs's risk as a commercial investor. The project provided an opportunity to advance the foundation's social mission—in this case, to increase support for the Mayor's Young Men's Initiative for the advancement of young African American and Hispanic men.[162] As it turned out, the project was terminated and Bloomberg Philanthropies paid Goldman Sachs $7.2 million, or 75 percent, of Goldman's loan.

The internal decision-making process of a foundation considering funding PFS projects is more complex than for typical grant-making. The substance of a PFS project may be familiar to a foundation with experience in making, monitoring, and evaluating grants to social service providers. But grants are typically made in situations where no private parties stand to benefit from the foundation's funding. In contrast, grants for PFS projects provide a base of support necessary to attract commercial investors. A successful project, which yields a profit for a bank, will be a total financial loss—as grants always are—for the foundation. Especially when the bar for success is low—as the press claimed it to be for the Utah early childhood initiative—it may appear that the foundation is inappropriately subsidizing a private investor.[163]

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[162] J. Hughes & J. Scherer. (2014, p. 34). *Foundations for Social Impact Bonds: How and Why Philanthropy Is Catalyzing the Development of a New Market*. Boston, MA. http://socialfinance.org/content/uploads/2015/10/Foundation-for-Social-Impact-Bonds-2014.pdf.

[163] N. Popper. (November 3, 2015). Success Metrics Questioned in School Program Funded by Goldman. *New York Times*. Retrieved February 9, 2019, from https://www.nytimes.com/2015/11/04/business/dealbook/did-goldman-

The difficult question for a foundation is how large a subsidy, and on what terms, is necessary to attract essential commercial capital. At stake are the opportunity costs of the foundation's grant funds, its reputation, and conceivably its compliance with IRS regulations prohibiting using charitable funds for private benefit.

In addition to, or instead of, making a grant, a foundation may make a program-related investment (PRI) in a PFS program. PRIs almost inevitably expect lower than risk-adjusted market returns, and foundations typically are junior lenders, who receive repayments only after the commercial lenders. A PRI may also be used to guarantee a commercial loan; Bloomberg Philanthropies guaranteed Goldman Sachs's loan in the New York City recidivism program. A PRI offers a foundation more flexibility than a grant to calibrate the size and terms of a subsidy. Making a PRI is considerably more complicated than making a grant and typically requires the input of staff with investment and legal as well as substantive program expertise.[164]

The Capital Stack

Investments and grants come together in different ways in different projects. The following chart shows the capital stacks for the Massachusetts and New York State recidivism projects and the Denver and Santa Clara County homelessness projects.

make-the-grade.html. The first year's results indicated that the project helped 99 percent of children being tracked avoid special education. Researchers believed that a much lower reduction would have been more realistic.

164 For this reason, among others, only a small fraction of staffed foundations in the United States make PRIs. For an example of the PRI risk assessment and accountability processes, see P. Brest. (2016). "Investing for Impact with Program-Related Investments," *Stanford Social Innovation Review*, 14(3), pp. 24–27. Retrieved February 12, 2019, from http://ssir.org/articles/entry/investing_for_impact_with_program_related_investments.

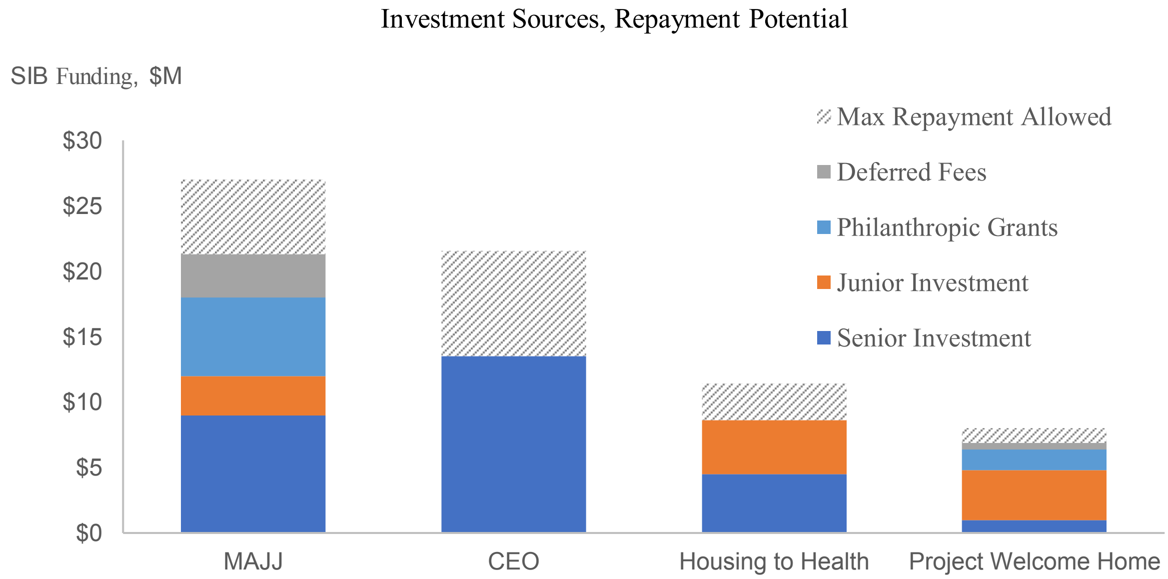

Table 4. Repayment types and schedule

Sources: (MAJJ Contract, 2014, p. 12; Appendix D-3-4; Appendix H-2-4, H-9-10, H-16, Denver PFS Contract, 2016, pp. 10–12, 14, 46–47, Appendix C1; State of New York et al., 2014, pp. 5, 15, 17–18; The County of Santa Clara California Office of the County Executive, 2015, pp. 10, 30–32).

The typical order of repayment in these programs is

- Loan interest
- Senior lender principal
- Junior lender principal
- Deferred service fees
- Grant recycling

Upon certification that success payments are due, the government transfers funds into a project account managed by an intermediary (often a special purpose vehicle), which then disburses to lenders in accordance with an agreed schedule.

The financing structures of the programs differ. The Massachusetts anti-recidivism program has a senior commercial investor, along with foundations serving as junior investors and making grants. The capital stack consists of $6 million in recyclable grants from the Laura and John Arnold Foundation, New Profit, Inc., and the Boston Foundation; $3 million as junior investments by the Kresge Foundation and Living Cities; and the $9 million senior investment from Goldman Sachs.

Quite unusually, the service provider and intermediary have also postponed some of their fees.[165] New York State's anti-recidivism program has only a senior investor—a forty-member investment group within the bank, composed of individuals, foundations, and the bank. It also has a small loan guarantee.[166]

Santa Clara County's Project Welcome Home has more subordinate than senior funding. Housing to Health in Denver, Colorado, has two tranches of investors. The senior investors receive repayments annually, and the junior investors will be repaid at the end of the project.

The timing of repayments and caps on the repayments differ. Because of the inevitable time delay in evaluating the success of a recidivism project, success payments typically cannot begin until a number of years after the initial drawdown. The Massachusetts program has four repayment periods, all toward the end of the project—at quarters 18, 19, 21, and 23. New York State's program has only two periods, the first after year 4 and the second after year 5.5. The Denver Housing to Health project has the simplest plan: repayment will be made only at the end of the project.

Intrinsic Project Costs and Transaction Costs

PFS projects are complex and costly in two ways. One set of costs—those involving designing evidence-informed interventions, identifying appropriate metrics, collecting and analyzing data for monitoring and evaluation, and active performance management—is intrinsic to every outcomes-based approach to providing social services. These costs are likely to decrease to some extent as practices evolve and the field gains knowledge and experience, especially if some kinds of interventions become standardized.

The other costs are the transaction costs involved in putting the deals together. The complexities of the overall process include

- Obtaining the government's budgetary allocations and binding commitment to make payments a number of years in the future
- Collaboration among government agencies and between governments and service providers in sharing data and in implementation
- Negotiating the metrics and other criteria on which success payments will be made
- Providing the service delivery organization with working capital

165 Although this was done by Roca and Third Sector Capital Partners in the MAJJ project, it is atypical and perhaps mostly symbolic; it is unrealistic to expect these organizations to forgo the working capital they need to implement the project. See S. Kodali, J. Grossman, & G. Overholser. (2014). *The Massachusetts Juvenile Justice PFS Initiative Project Brief*. Retrieved February 10, 2019, from http://www.thirdsectorcap.org/wp-content/uploads/2015/02/TSCP_MAJJ-PFS-Project-Brief.pdf.

166 State of New York, Center for Employment Opportunities, & Social Finance. (2014).

- Negotiating the government's, service providers', and investors' various interests, risk tolerances, and desires for financial returns.

To elaborate on the last of these:

- Government payers want to ensure that they pay only for good social outcomes or actual cost savings.
- Service providers need adequate working capital and want to ensure success: achieving social outcomes with reasonably attainable targets.
- Philanthropic funders wish to achieve social outcomes commensurate with the amounts granted or sacrificed through below-market PRIs. They want to provide enough capital to attract commercial investors to the project, but not to bestow private benefits on them.
- Commercial investors, no matter what their interest in social outcomes may be, expect to ensure a market financial return. They prefer seniority in the repayment structure, a payment guarantee, a low success target, and payments sooner rather than later.
- Intermediaries want to ensure adequate compensation for their facilitation of the program.

Here too, solutions may lie in standardization among projects with similar interventions, perhaps through templates that can be used for various parts of the contract. So far, the market has been too small and too varied to develop a standard approach.

Termination of the Project

In addition to negotiation over these other matters, the parties will wish to specify the terms under which a project can be terminated before its completion. The most common contractual grounds for termination are unanticipated changes in the project's implementation or in external circumstances that render successful completion infeasible. New York City's Riker's Island recidivism project was terminated for both reasons. The homelessness PFS projects have clauses to permit early termination in the event of an insufficient supply of affordable housing units. Each party wants to come out of an early termination with its interests as well-protected as possible.

Termination upon a PFS program's *success* may also present problems for some stakeholders. The government may decide to run the program itself, building on the knowledge gained from the service provider's work. But this decision deprives the provider of the opportunity to continue the project. Or, as in the case of the UK Peterborough prison project, the government may continue to outsource the program, paying the service provider directly without the complex financing machinery of social innovation financing. Although direct payment would please both the service provider and its philanthropic funders, it might deprive commercial investors of long-term opportunities.

Even if the project continues, the government may press to reduce the payment terms because the success of the first program reduces the risks of failure. In any event, because of possible differences in the target populations and external circumstances, the benefits and costs of the continued program may be different from the original one.

Conclusion

Pay for success programs have seen impressive growth since the pioneering UK Peterborough program in 2010. At the end of 2018, roughly 100 PFS projects are in progress around the world. If evidence-informed, outcome-oriented provision of social services is so promising, why has adoption been so meager? Of course, it has been less than a decade—still early days. But the projects undertaken to date reveal barriers created by the competing interests of the many parties involved, the difficulties of coordinating activities among the parties, the costs of gathering and evaluating data, and the complexities of financing.

At the beginning of this handbook, we mentioned questions that a government agency should ask about these sorts of issues before beginning to pursue a PFS program. Here we mention some other concerns as well. Some are intrinsic to the practice:

- Though we think that Kasturi Rangan and Lisa Chase exaggerate when they assert that "many social interventions simply defy the kind of impact measurement and linkage to financial savings that the PFS structure demands,"[167] measurement certainly can be complex and sometimes more costly than justified by its benefits.
- PFS favors relatively large and established providers over smaller and newer community-based organizations.
- PFS entails directing funds toward projects that are quite likely to work, not risking capital to explore potential new ideas and fund new nonprofit entrants.[168]
- PFS programs may lead to the privatization of services that some believe should be provided by governments.
- PFS doesn't come to grips with systemic causes of poverty, discrimination, and other forms of inequality.

Some of these concerns would be apt if PFS were offered as a panacea to replace all other social interventions designed to benefit poor and vulnerable populations. But it is not. In many cases, the PFS programs are aimed at replacing existing programs that are poorly designed or poorly executed. As for the last concern mentioned, there is simply no evidence that forgoing individual

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167 V. K. Rangan & L. A. Chase. (2015). "The Payoff of Pay-for-Success," *Stanford Social Innovation Review* (Fall), pp. 28–39. Retrieved from http://0search.ebscohost.com.brum.beds.ac.uk/login.aspx?direct=true&db=sih&AN=109457325&site=ehost-live&scope=site. (2015, pg. 31).

168 R. Cohen. (June 12, 2014). "Eight Sobering Thoughts for SIB Supporters." Retrieved April 17, 2017, from https://nonprofitquarterly.org/2014/06/12/eight-thoughts-social-impact-bonds/

Commonwealth of Massachusetts. Section 35VV: Social Innovation Trust Fund (2012). Retrieved February 20, 2019, from https://malegislature.gov/Laws/GeneralLaws/PartI/TitleII/Chapter10/Section35VV.

solutions would increase the likelihood of governments' turning their attention to the deeper causes of social problems.

Other concerns are particularly related to social innovation financing:

- Commercial investors may press for low performance thresholds to reduce their risks.
- It is inappropriate for commercial investors to make a profit by helping vulnerable people.
- The financing of PFS projects allows unelected and unappointed philanthropic and commercial funders to choose projects that appeal to their whims and interests, giving them too much power and influence over the lives of the vulnerable people they serve.

We are sympathetic to the first concern. The solution is for the government to push back or look for purely philanthropic funders. The second point strikes us as essentially ideological. We don't see anything inherently wrong with for-profit investors supporting socially valuable services. In our view, the important question is whether the services are valuable and cost-effective. The last point is met when—as appears to be true of all PFS projects to date—governments undertake only PFS projects that reflect their own priorities and overcome funding barriers particularly for innovative, untested programs. In these cases, the needs for the services supported by funders are so deep that their funding barely scratches the surface. For better or worse, whatever power philanthropists have over vulnerable beneficiaries is justified by the beneficiaries' immense needs.

In any case, we should emphasize that PFS is not an end in and of itself, but rather a tool to improve outcomes for the beneficiaries of government-funded social services in a cost-effective manner and, more fundamentally, to induce governments, service providers, philanthropists, and other stakeholders to develop evidence-informed, outcome-oriented mindsets and processes. The entire movement toward outcomes is young, and PFS will surely not look the same in the next decade as it does now. Perhaps it will turn out to be just a waystation to other practices. But right now, it is an important catalyst for the movement.

We end on a central theme of this text. The key to an effective PFS program lies in the hands of the government officials and agencies that initiate and implement the program. A successful program originates in an agency's desire to achieve particular social outcomes and its decision that a non-governmental service provider can contribute mightily in producing those outcomes. The agency's senior management must be committed to the social objectives. It must dedicate human and financial resources to the project and enlist the cooperation of other relevant agencies. An intermediary organization can help gain and cement these commitments, but only on a foundation laid by the government itself.

APPENDIX: OTHER PFS PROGRAMS

Recidivism-reduction programs address a serious social problem. Their basic metric is based on reliable administrative data (whether or not a person is incarcerated); and they are relatively easy to evaluate. For these reasons, they have been among the most popular PFS programs in the United States. States that use PFS to reduce recidivism include New York, Massachusetts, California, Pennsylvania, Colorado, Oregon, and Alaska.[169]

HMP Peterborough (UK) Social Impact Bond Pilot (2010). In the pioneer PFS program at the Peterborough Prison in the United Kingdom, the government payer was the UK Ministry of Justice supported by the Big Lottery Fund, a national lottery that supports charitable projects throughout the UK.

Service providers delivered individualized support to enable the ex-offenders to more effectively bridge the gap between custody and their communities under a program called One Service.[170] The goal was to reduce recidivism by at least 7.5 percent across all cohorts. There was also an opportunity for early payments if One Service reduced reoffending by 10 percent for any individual cohort. Social Finance served as the intermediary. The benchmark for success was a comparison group composed of other ex-offenders released at the same time.

Seventeen social investors—charitable trusts and foundations—committed £5m to fund rehabilitative interventions for prisoners for one year after their release from Peterborough prison in the UK.[171] The investors were to be paid by the Big Lottery Fund and the Ministry of Justice

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169 Rayanne Hawkins, Mayookha Mitra-Majumdar, David McClure, & Ellen Paddock. (2017). *Using Pay for Success in Criminal Justice Projects*. Urban Institute. Retrieved January 28, 2019, from https://www.urban.org/sites/default/files/publication/94736/using-pay-for-success-in-criminal-justice-projects_1.pdf.

170 The services provided were aimed at helping ex-offenders (short-sentenced male prisoners) find stability after release. They included advisory and guidance services related to obtaining ID cards, accommodation, medical care, family support, employment and training, benefits, and financial advice. For more detail, see E. Disley, C. Giacomantonio, K. Kruithof, & M. Sim. (2015). *The payment by results Social Impact Bond pilot at HMP Peterborough: Final process evaluation report.* Retrieved January 10, 2019, from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/486512/social-impact-bond-pilot-peterborough-report.pdf.

only if the target objectives of reduced recidivism were reached.[172] The program reduced recidivism by 9 percent, exceeding the 7.5 percent aggregate recidivism target rate; investors were repaid the principal amount plus an amount that represented a return of just over 3 percent per annum for the period of investment.[173] Although the program was supposed to span three cohorts over seven years, it was discontinued after two cohorts and five years. The Ministry of Justice made changes in its own service-delivery practices[174] that made the PFS an inefficient duplication of efforts and impossible to evaluate. The Ministry of Justice continued the program on a fee-for service basis until the changes to their services for short-sentenced offenders took effect.[175]

Adolescent Behavioral Learning Experience Program (New York City, 2012). The Adolescent Behavioral Learning Experience *(ABLE)* program offered cognitive behavioral therapy and moral reconation therapy[176] to young men exiting the Rikers Island prison in New York City. MDRC oversaw the implementation of the project by two nonprofit service-providers whose methods had

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[172] E. Disley & J. Rubin. (2014). *Phase 2 report from the payment by results Social Impact Bond pilot at HMP Peterborough.* Retrieved February 9, 2019, from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/325738/peterborough-phase-2-pilot-report.pdf.

[173] Jake Anders & Richard Dorsett. (2017). *HMP Peterborough Social Impact Bond - cohort 2 and final cohort impact evaluation* (National Institute of Economic and Social Research). Retrieved February 5, 2019, from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/633243/peterborough-social-impact-bond-cohort-2-results-report.pdf; and Liam Kay. (2017). *World's first social impact bond achieved goals and repaid investors* (Third Sector). Retrieved February 1, 2019, from https://www.thirdsector.co.uk/worlds-first-social-impact-bond-achieved-goals-repaid-investors/finance/article/1440676.

[174] The Ministry of Justice introduced the Transforming Rehabilitation (TR) reforms, whose aim is to reduce reoffending using a payment-by-results approach to rehabilitation of inmates. "Prior to the PFS program, short-term (<12 months) male offenders did not receive rehabilitation services, a gap the program was able to fill. With the implementation of TR at the end of 2014, this contingent of offenders will no longer be left out by the UK's overarching strategy for rehabilitation," *Social Finance*, 2014, paragraph 2. See also: https://apolitical.co/solution_article/worlds-first-social-impact-bond-uk-cuts-recidivism-rewards-investors/ (accessed on February 10, 2019).

[175] Disley, Giacomantonio, Kruithof, & Sim. (2015).

[176] The Osborne Association, one of the service providers for the project, defines moral reconation therapy (MRT) as "the process of relearning how to think and act as a responsible person. MRT is a form of cognitive behavioral therapy, an approach which, over a span of 30 years, has been shown by research to have the most positive impact on criminal justice populations" (paragraph 1). The Osborne Association. (2012). Moral Reconation Therapy. Retrieved April 20, 2017, from http://www.osborneny.org/programSubPage.cfm?subPageID=44

demonstrated reductions in recidivism rates[177] but had never been tested on such a large scale.[178] The program sought to reduce recidivism bed days[179] by 10 percent against a benchmark of matched past ex-offenders. Bed days for 16- to 18-year-olds participating in the program in 2013 were matched with prisoners released from Rikers between 2006 and 2010.[180] The program was financed entirely by a $7.2 million loan from Goldman Sachs to MDRC. Bloomberg Philanthropies guaranteed $6 million, or 83 percent, of the loan, substantially reducing Goldman Sachs's risk. An 8.5 percent reduction in the rate of recidivism would have triggered repayment of principal, and a reduction greater than 10 percent would have led to a profit for Goldman.[181]

The program encountered a host of implementation and measurement problems. Administrators could not properly identify ex-offenders who were supposed to participate in cognitive behavioral therapy.[182] The New York City Department of Education was unable to provide instructors as called for by the program. Implementation was disrupted by security problems. And the budget of one of the service providers was cut when Rikers's teenage population fell below the number

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177 G. L. Little & Robinson. K. D. (2018). "Effects of moral reconation therapy upon moral reasoning, life purpose, and recidivism among drug and alcohol offenders," *Psychological Reports*, 64(1), pp. 83–90. Retrieved February 13, 2019, from https://doi.org/10.2466/pr0.1989.64.1.83; and P. Phipps, K. Korinek, S. Aos, & R. Lieb. (1999). "Research Findings On Adult Corrections' Programs: A Review," *Washington State Institute for Public Policy*. Olympia. Retrieved February 13, 2019, from http://www.wsipp.wa.gov/ReportFile/1309/Wsipp_Research-Findings-on-Adult-Corrections-Programs-A-Review_Full-Report.pdf.

178 L. Farmer. (2015). "Are Governments 'Paying for Failure' with Social Impact Bonds?" *Governing*. Retrieved February 13, 2019, from http://www.governing.com/topics/finance/gov-social-impact-bonds.html.

179 The project measured "recidivism bed days" as "the number of days that members of the study cohort were held in the jail during the 12 months following their release from Rikers." The Vera Institute of Justice was the independent evaluator in the Rikers ABLE project. J. Parsons, C. Weiss, & Q. Wei. (2016). *Impact Evaluation of the Adolescent Behavioral Learning Experience (ABLE) Program.* Retrieved February 13, 2019, from .

180 The groups were matched on several factors including charge, criminal history, gender, and age via propensity score matching. Parsons, J., Weiss, C., & Wei, Q. (2016).

181 City of New York. (2012). *Fact Sheet: The NYC ABLE Project for Incarcerated Youth*. New York. Retrieved February 13, 2019 from http://www.nyc.gov/html/om/pdf/2012/sib_fact_sheet.pdf.

182 E. Porter. (July 28, 2015). "Wall St. Money Meets Social Policy at Rikers Island. *New York Times*. Retrieved February 13, 2019, from https://storage.googleapis.com/vera-web-assets/downloads/Publications/rikers-adolescent-behavioral-learning-experience-evaluation/legacy_downloads/rikers-adolescent-behavioral-learning-experience-evaluation.pdf. The Vera Institute of Justice had anticipated this risk when establishing the measuring mechanism. It established that a randomized control trial—comparing a treatment group randomly assigned to receive the therapy with a control group that did not— was not feasible because inmates were frequently moved between housing units. To avoid such risk, the Vera Institute used a historical group as control group. Nevertheless, this adjustment was not enough to guarantee good impact measurement.

contracted for.[183] The program was aborted after the evaluator determined that it did not result in a statistically significant reduction in recidivism, let alone meet the target reduction in bed days of 10 percent.[184] Under the circumstances, New York City paid nothing. Thanks to Bloomberg Philanthropies' loan guarantee, Goldman was only $1.2 million out of pocket.[185]

Massachusetts Juvenile Justice PFS Initiative (2014). In Massachusetts, another PFS program seeks to decrease recidivism and increase employment opportunities for young men in the commonwealth's juvenile justice system. The nonprofit service provider Roca offers cognitive-restructuring and skills development interventions to juvenile ex-offenders. Using prior evaluations of Roca's effectiveness in reducing recidivism rates as a baseline,[186] the parties agreed to a very ambitious minimum target: a 40 percent decrease in days of reincarceration, compared to the commonwealth's average rate, over seven years.[187] Although the principal metric is avoided days in jail, the Massachusetts program uses judges' sentences as a proxy.

The commonwealth will begin making success payments when the program achieves a 5.2 percent reduction in re-incarceration. Upon reaching the target of a 40 percent decrease , lenders' principal will be fully repaid with interest of up to 5 percent, and Roca and Third Sector will be paid their deferred fees. At higher levels of impact, Goldman, which invested $9 million, could get as much as $1 million, the junior lenders up to $300,000 each, and Roca up to $1 million in success payments.[188] At the 40 percent break-even point, the program's payouts to funders and the savings for the government would both equal $22 million, and funders would be fully reimbursed. If the program exceeds the target reduction in recidivism, Massachusetts could save as much as $45 million over seven years. The investors' success payments are capped at $27 million, thus allowing the commonwealth to capture all additional cost savings.[189] Like New York State's CEO

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183 G. L. Berlin. (2016). *Learning from Experience: A Guide to Social Impact Bond Investing*. Retrieved February 13, 2019, from https://www.mdrc.org/sites/default/files/Learning_from_Experience_SIB.pdf; and Porter. (2015).

184 Parsons, Weiss, & Wei. (2016).

185 The Bond Buyer. (2015). *No Success like Failure: NY Sees Social Impact Bond Pluses*. Retrieved February 14, 2019, from https://www.mdrc.org/news/mdrc-news/no-success-failure-ny-sees-social-impact-bond-pluses.

186 Roca. (2017).

187 S. Kodali, J. Grossman, & G. Overholser. (2014). *The Massachusetts Juvenile Justice PFS Initiative Project Brief*. Retrieved February 10, 2019, from http://www.thirdsectorcap.org/wp-content/uploads/2015/02/TSCP_MAJJ-PFS-Project-Brief.pdf.

188 Id.

189 Roca did not begin reporting outcomes until 2018. Roca reports: "Roca's internal tracking shows that Roca's performance meets the projections: at the two year mark, overall retention rate was 73% (planned: 70%), attrition to

program, the Massachusetts Juvenile Justice program also includes payments for job placement, which can be thought of as a valuable outcome independent of recidivism or as an intermediate outcome that is likely to reduce recidivism. The Massachusetts metric is based on each quarter that a Roca participant is employed.

Ventura County Project to Support Reentry (2017). In April 2016, the California Board of State and Community Corrections (BSCC) awarded grants for pilot PFS projects to reduce recidivism rates, subject to the recipients securing matching funding, to Ventura County, Alameda County, and Los Angeles County.[190]

The Ventura County program is a collaborative project between the County Executive Office, County Probation Agency, Interface Children & Family Services and Social Finance. It is funded by the Reinvestment Fund, Nonprofit Finance Fund, and Whitney Museum of American Art. The project aims to reduce recidivism by providing programs customized to an ex-offender's individual needs over four years to 400 adults on formal probation in Ventura County.[191] Through an RCT conducted with the University of California at Los Angeles, participants will be placed in the program or into a control group.[192] The metrics triggering outcome payments will be the number of quarters in which a client is not arrested and reduction in recidivism over a period of 12 months, compared to the control group.

Alameda County Justice Restoration Project (2018). Under the same pilot project, the program in Alameda County, coordinated by Third Sector, aims to reduce recidivism by providing support services such as treatment for substance abuse, employment training, adult education, mental health services, intensive case management, and housing assistance. The interventions include coaching and mentoring by people with similar life experiences. The program plans to serve approximately 200 young adults between the ages of 18 and 24.[193] The services will be delivered

incarceration was almost at plan (actual: 19; planned: 17), and overall attrition was lower than expected (actual: 74; planned: 78)." (Roca, 2016, para. 9).

190 Rayanne Hawkins, Mayookha Mitra-Majumdar, David McClure, & Ellen Paddock. (2017).

191 Social Finance. *Ventura County Project to Support Reentry fact sheet*. Retrieved September 15, 2018, from http://socialfinance.org/content/uploads/VCProjectToSupportReentry_Overview.pdf.

192 Social Finance. *Ventura County Project to Support Reentry*. Retrieved September 15, 2018, from http://socialfinance.org/focus-areas/criminal-justice/ventura-county-project-to-support-reentry/ and Nonprofit Finance Fund. *Pay For Success blog*. Ventura County Project for Reentry. Retrieved September 15, 2018, from https://payforsuccess.org/project/ventura-county-project-support-reentry.

193 Alameda County District Attorney's Office website. (2017). *Alameda County Justice Restoration Project Launched*. Retrieved February 13, 2019, from http://www.alcoda.org/newsroom/2017/sep/justice_restoration_project; and Nonprofit Finance Fund. Pay For

by La Familia Counseling Services and the county. The project's funder is Reinvestment Fund. Success payment will be determined by WestEd and will be based on agreed milestones in participants' reduced recidivism and improvements in their mental health, employment, and family relationships. The funds for the success payments will be provided by the Board of State and Community Corrections and Alameda County. The Nonprofit Finance Fund, the James Irvine Foundation, and the Social Innovation Fund also supported the development stages of the project.[194]

Salt Lake City, UT. Recovery, Engagement, Assessment Career and Housing Program (REACH) (2017). In 2017, Salt Lake County launched the *REACH*project . Over 5 years, the program aims to provide behavioral health treatment, housing, and case management services to 225 formerly incarcerated adult men in order to lower their likelihood of recidivism.[195] Enrollment for the PFS beneficiary population is voluntary. Adult Probation and Parole will share with First Step House a list of eligible men based on pre-sentence investigations.

The first phase of the project involves behavioral treatment, with housing provided by First Step House if needed, followed by support in maintaining connections with social and recovery networks, as well as stable employment and housing. The project will be evaluated through an RCT conducted by the University of Utah Criminal Justice Center.

Partial repayment of principal occurs if the treatment group fares better than the control group. Full repayment happens if the project achieves a reduction between 15 percent and 20 percent in days incarcerated. Success payments are based on 66.4 percent treatment engagement, 35 percent reduction in arrests, 35 percent reduction in days incarcerated, and 25 percent improvement in employment. Northern Trust, Ally Bank, QBE Insurance, Sorenson Impact Foundation, Sorenson Family Foundation, and Living Cities are investors. Non-recoverable grants were provided by Eccles Foundation, Noora Foundation, Miller Family Foundation, Zions Bank, Synchrony Bank, Nonprofit Finance Fund, Ally Bank, and County Escrow.[196]

Women in Recovery (WIR), (Tulsa, OK, 2017). Family & Children's Services launched WIR in 2009 to reduce Tulsa County's high female incarceration rate by providing substance abuse and

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Success blog. *Voices of PFS Pioneers: Alameda County Justice Restoration Project*. Retrieved September 17, 2018, from https://payforsuccess.org/blog/voices-pfs-pioneers-alameda-county-justice-restoration-project-acjrp.

194 Id.

195 Available at: Nonprofit Finance Fund. Pay For Success blog. *Project Salt Lake County REACH*. Retrieved September 15, 2018, from https://payforsuccess.org/project/salt-lake-county-reach; and Third Sector Capital Partners blog. *Fact Sheet: Salt Lake County Pay For Success Initiative*. Retrieved September 15, 2018, from http://www.thirdsectorcap.org/wp-content/uploads/2016/12/161216_SLCo-Fact-Sheet-FINAL.pdf.

196 Id.

mental health treatment, workforce readiness training, and assistance with parent-child reunification to formerly incarcerated women. Following legislation authorizing PFS programs in 2017, Oklahoma issued a public bid for proposals for WIR.[197] Voluntary enrollment is offered in conjunction with the Criminal District Court, with referrals coordinated by the service provider, judges, public defenders, district attorneys, and local supervision entity. Social Finance served as the advisor to the project. Success payments of $5,646 are paid upon a participant's graduation from the program and then at 24, 36, and 54 months not back in prison. Payments are not based on an RCT, but on data from the service provider and Oklahoma Department of Corrections.

FAMILIES AND CHILDREN

South Carolina Nurse-Family Partnership Pay for Success Project (NFP) (2016). Registered nurses visit low-income, first-time mothers during their pregnancy and children's infancy with the goal of improving child and maternal outcomes. For many years, the organization's interventions were supported by philanthropists and had been subjected to at least three well-conducted randomized controlled trials.[198]

The NFP project was launched in 2016 with the specific goals of "reduction in preterm births, reduction in child hospitalization and emergency department usage due to injury, increase in healthy spacing between births, and increase in the number of first-time moms served in predetermined ZIP codes with high concentrations of poverty."[199] The project aims to reach 3,200 first-time, low-income mothers in South Carolina over four years.

Social Finance raised the capital for the project and acts as the project intermediary. The Children's Trust of South Carolina is the fiscal agent, and the Harvard Kennedy School Government Performance Lab provides technical assistance.

Medicaid is providing approximately $13 million via a Medicaid Waiver awarded to the South Carolina Department of Health and Human Services, and philanthropic funders have committed

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[197] Nonprofit Finance Fund. *Pay For Success blog*. Oklahoma Women in Recovery, Retrieved September 20, 2018, from https://payforsuccess.org/project/oklahoma-women-recovery]; and Social Finance. *Fact Sheet Oklahoma Pay for Success: Family and Children's Services – Women in Recovery*. Retrieved September 16, 2018, from http://socialfinance.org/content/uploads/External-Fact-Sheet.pdf.

[198] Coalition for Evidence-Based Policy. (2014, June). Social Programs That Work: Nurse-Family Partnership. Retrieved April 25, 2017, from http://evidencebasedprograms.org/1366-2/nurse-family-partnership.

[199] Nurse-Family Partnership. (2016). *Fact Sheet: South Carolina Nurse-Family Partnership Pay for Success Project*. Denver. https://www.scdhhs.gov/sites/default/files/2-16-16-SC-NFP-PFS-Fact-Sheet_3.pdf. Retrieved March 7, 2019.

$17 million. The program has no commercial investors. The South Carolina Department of Health and Human Services will make up to $7.5 million in success payments, which will be reinvested in the project[200] to sustain the activities of Nurse-Family Partnership if it attains outcomes measured by a randomized controlled trial performed by independent evaluator J-PAL North America.[201]

Connecticut Office of Early Childhood Maternal, Infant, and Early Childhood Home Visiting Outcomes Rate Card Pilot (2018). In 2018, with the assistance of Social Finance, the Connecticut Office of Early Childhood (OEC) launched a year-long PFS rate card pilot program.[202] OEC will incorporate bonus payments into existing service providers' 2018 contracts[203] for achieving four specified outcomes:[204]

- Full-term birth: the child is born at 37 weeks gestation or later.
- Safe children: there are no substantiated cases of maltreatment and no incidents of injury requiring visits to the emergency room.
- Caregiver employment: at the time of measurement, the caregiver (typically the mother) is employed, is enrolled in education or training, or has recently graduated from an education or training program.
- Family stability: The basic needs of families for child care, health care, and housing are met.

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200 "In the hope of cultivating a path to long-term, sustainable funding of NFP in South Carolina, the investors are rolling over any success payments into ongoing NFP operations in the state." https://govlab.hks.harvard.edu/south-carolina-nurse-family-partnership-pay-success. Accessed March 7, 2019.

201 Id.

202 Connecticut's Official State website. Connecticut Office of Early Childhood – Maternal, Infant, and Early Childhood Home Visiting Outcomes Rate Card Pilot Fact Sheet. Retrieved February 10, 2019, from https://www.ct.gov/oec/lib/oec/ct_oec_miechv_rate_card_fact_sheet.pdf; and Nonprofit Finance Fund. *Pay For Success blog*. Connecticut Office Early Childhood Maternal, Infant, and Early Childhood Home Visiting. Retrieved November 1, 2018, from https://www.payforsuccess.org/project/connecticut-office-early-childhood-maternal-infant-and-early-childhood-home-visiting.

203 Existing network of 22 providers that deliver home visiting services to 1,300 at-risk families (the providers include Parents as Teachers, Early Head Start (EHS), Nurse Family Partnership and Child First).

204 Connecticut's Official State website. Connecticut Office of Early Childhood – Maternal, Infant, and Early Childhood Home Visiting Outcomes Rate Card Pilot Fact Sheet. Retrieved February 10, 2019, from https://www.ct.gov/oec/lib/oec/ct_oec_miechv_rate_card_fact_sheet.pdf; and Nonprofit Finance Fund. *Pay For Success blog*. Connecticut Office Early Childhood Maternal, Infant, and Early Childhood Home Visiting. Retrieved November 1, 2018, from https://www.payforsuccess.org/project/connecticut-office-early-childhood-maternal-infant-and-early-childhood-home-visiting.

OEC renewed the pilot in 2019 with adjusted prices based on 2018 results; OEC will adjust and continue the program in future years.[205]

Connecticut Family Stability Pay for Success Project (2016). In 2016, Connecticut launched a project to promote family stability and reduce parental substance use among 500 families served by the Connecticut Department of Children and Families. The project drew on the Family-Based Recovery program, developed at the Yale Child Study Center, under which treatment teams visit families to promote positive parent-child interactions, increase parental awareness and understanding of child development, and help parents maintain recovery from substance use.[206]

Social Finance serves as the intermediary, with the assistance of the Harvard Kennedy School Government Performance Lab. The University of Connecticut Health Center will be the independent evaluator.[207] Social Finance helped raise $11.2 million from private investors, including BNP Paribas and several other commercial and philanthropic organizations. Payouts for the project are based on four measures: enrollment in the FBR program, number of out-of-home placements prevented, reduction in re-referrals to DCF, and decreased substance use.[208] Although the first of these is for the provision of services, the other three are for outcomes.

HOMELESSNESS

Massachusetts Chronic Individual Homelessness PFS Initiative (2014). The initiative is a six-year project launched in 2014 to increase permanent housing availability throughout Massachusetts. Eighteen service providers, coordinated by the Massachusetts Housing and Shelter Alliance (MHSA), will produce 500 stable housing units for up to 800 chronically homeless

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[205] Connecticut's Official State website. Connecticut Office of Early Childhood – Current Contracts. Retrieved April 10, 2019, from https://www.ct.gov/oec/cwp/view.asp?A=4547&Q=581074.

[206] Connecticut Department of Children and Families. (2016). *Connecticut Family Stability Pay for Success Project Fact Sheet*. Retrieved February 9, 2019, from http://www.ct.gov/dcf/lib/dcf/socialimpactbonds/pdf/ct_family_stability_pfs_fact_sheet_vfinal_(2).pdf.

[207] Social Finance. (2016b, September). Connecticut Family Stability Pay for Success Project. Retrieved April 29, 2017, fromhttp://socialfinance.org/focus-areas/children-and-families/connecticut-family-stability-pay-for-success-project/.

[208] Id.

people.[209] As the coordinator, MHSA provides technical assistance to the service providers as well as program monitoring, data collection, and reporting.[210]

Success payments come from the commonwealth's budget; operating capital comes from $1 million in philanthropic investments and $2.5 million in private commercial investments from United Way of Massachusetts Bay and Merrimack Valley, the Corporation for Supportive Housing, and Santander Bank N.A. Success payments will be based on the housing outcome, with repayments triggered when participants are in stable residency for at least one year. Depending on the outcomes, investors may be fully repaid and may earn a return on their investments, currently capped at 5.33 percent. Root Cause will be the independent evaluator of the program.[211]

Denver, CO, Housing to Health PFS Project (2016). In February 2016, the City of Denver launched a project to provide permanent housing and supportive services to up to 250 chronically homeless people within five years. The program aims to simplify access to housing and provide the target population with healthcare, employment, and substance abuse treatment services. Social Impact Solutions helped raise $8.63 million from private investors, which the city will repay only if the project achieves specified outcomes. For the outcomes related to housing, the city will pay $15.12 for each day spent in housing (minus the number of days that a participant spends in jail), but only if a participant spends at least twelve months in housing. The program also measures success in terms of reduced jail bed days for its participants. It is evaluated by the Urban Institute, which will use an RCT.[212]

Los Angeles, CA. Just-in-Reach Project (2017). In 2017, Los Angeles launched a public-private collaboration to improve overall health and well-being of homeless people in LA County.[213]

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209 Massachusetts Housing & Shelter Alliance, Corporation for Supportive Housing, & United Way of Massachusetts Bay and Merrimack Valley. (2017). *Pay for Success 2017 Fact Sheet*. Retrieved February 9, 2019, from https://www.mhsa.net/sites/default/files/PFS%20Fact%20Sheet%20December%202017.pdf

210 Office of Governor Deval L. Patrick. (2014, December 8). Massachusetts Launches Pay for Success Initiative to Reduce Chronic Individual Homelessness. *Commonwealth of Massachusetts Executive Department Press Release*. Retrieved February 5, 2019, from http://archives.lib.state.ma.us/bitstream/handle/2452/217588/ocn795183245-2014-12-08b.pdf?sequence=1&isAllowed=y.

211 Id.

212 Denver PFS, LLC (2016). Denver, CO. Retrieved January 28, 2019, from http://www.payforsuccess.org/sites/default/files/resource-files/Denver PFS Contract_201523939_20160205_172505.pdf.

213 Urban Institute. *Los Angeles County Just in Reach Project*. Retrieved February 10, 2019, from https://pfs.urban.org/pfs-project-fact-sheets/content/los-angeles-county-just-reach-project; and Nonprofit Finance Fund. Pay For Success blog. *Los Angeles Just in Reach Project*. Retrieved January 28, 2019, from https://payforsuccess.org/project/los-angeles-county-just-reach-project.

Over four years, the program seeks to place in permanent supportive housing 300 homeless people with psychiatric or substance-abuse disorders who are currently in custody in a county jail. The metrics of success are specified reductions in rates of re-incarceration and homelessness.[214] The project is managed by the Corporation for Supportive Housing and the National Council on Crime & Delinquency.[215] The Los Angeles County Department of Health Services Intensive Case Management Providers[216] and Brilliant Corners (Flexible Housing Subsidy Pool Operator)[217] are responsible for the delivery of services. The project is initially funded by a $7 million loan from United Healthcare[218] and a $3 million loan from the Conrad N. Hilton Foundation. The repayment of the principal plus interest—in case the project meets its targets—will be made by LA County, the US Department of Housing & Urban Development, and the California Board of State and Community Corrections.

Salt Lake County Homes Not Jail (2017). Alongside REACH (described above), Salt Lake City launched a program to offer 315 people housing assistance and support services to improve housing stability and behavioral health and reduce incarceration.[219] The program's interventions

214 The program description states, "Although some PFS initiatives have utilized a randomization approach such that eligible participants are assigned to an intervention or comparison group in which approximately half receive the intervention, the PFS workgroup members did not perceive this approach as feasible for this project as it would require identifying through a referral and screening process twice as many individuals than [sic]would receive the intervention. This approach would require additional staffing to refer and screen individuals to a control condition." Available at http://file.lacounty.gov/SDSInter/bos/supdocs/114738.pdf.

215 Id.

216 The Office of Diversion and Reentry of the department will manage the program (Third Sector Capital Partners. *Los Angeles County Launches Just In Reach Supportive Housing Program to Break Cycles of Homelessness and Re-incarceration*. Retrieved September 15, 2018, from https://www.thirdsectorcap.org/news/los-angeles-county-launches-just-in-reach-supportive-housing-program-to-break-cycles-of-homelessness-and-re-incarceration/.

217 The PSH will be provided through LA County Flexible Housing Subsidy Pool (FHSP). Brilliant Corners is responsible for operating the FHSP program and will provide the housing units to be used in the program. (Los Angeles County Health Agency. *Approval of an Agreement with JIR Pfs, LLC for the Just In Reach Pay For Success Program and Other Related Delegations of Authority*. Retrieved September 15, 2018, from http://file.lacounty.gov/SDSInter/bos/supdocs/114738.pdf.

218 Considered to be the first healthcare company to invest in PFS in California (Nonprofit Finance Fund and the James Irvine Foundation. (2017). *Pay For Success Scorecard: Lessons from the Vanguard of the Outcomes Movement*. Retrieved September 15, 2018, from https://www.nonprofitfinancefund.org/sites/default/files/paragraphs/file/download/Pay%20for%20Success%20Scorecard.pdf.

219 Nonprofit Finance Fund (2018). *Salt Lake County Homes Not Jail*. Retrieved September 15, 2018, from https://payforsuccess.org/project/salt-lake-county-homes-not-jail; and Urban Institute. *Salt Lake County Homes Not Jail Program*. Retrieved September 15, 2018, from https://pfs.urban.org/pfs-project-fact-sheets/content/salt-lake-county-s-homes-not-jail-program.

include rent assistance in the private rental market and individual counseling.[220] The county will use data from its Homelessness Management Information System to invite people to participate.

The Homes Not Jail project will be evaluated through an RCT by the University of Utah Criminal Justice Center. Northern Trust, Ally Bank, QBE Insurance, the Reinvestment Fund, Sorenson Impact Foundation, and Sorenson Family Foundation are investors in the project. Moreover, Noorda Foundation, Miller Family Foundation, Nonprofit Finance Fund, Ally Bank, and County Escrow contributed to the project with a non-recoverable grant.221

The trigger for initial repayment of principal is better performance than the control group. The threshold for full repayment of principal is a reduction in months without jail or shelter between 15 percent and 20 percent. Full repayment of principal, plus maximum success payments, occurs under 100 percent enrollment in mental health services, 100 percent enrollment in substance abuse services, 30 percent improvement in months without jail or shelter, and 80 percent residency in stable housing.[222]

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220 Reinvestment Fund. *Success Story: Homes Not Jail*. Retrieved September 15, 2018, from https://www.reinvestment.com/success-story/homesnotjailprogram/.

221 Nonprofit Finance Fund (2018).; and Urban Institute. *Salt Lake County Homes Not Jail Program*. Retrieved September 15, 2018, from https://pfs.urban.org/pfs-project-fact-sheets/content/salt-lake-county-s-homes-not-jail-program.

222 Id.