

# The Next Frontier of Community Development: Pay for Success and Social Impact Bonds

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*Organized by the Federal Reserve Bank of San Francisco*

**Ian Galloway**

*Senior Research Associate,*

*Community Development*

*Federal Reserve Bank of San Francisco*

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# Welcome

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- Conference code: 25013029
- Webinar link: <https://www.webcaster4.com/Webcast/Page/584/4944>

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- Type your question into the chat box of the webinar.

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In connection with this session, you can find a variety of additional resources on this topic , available at [www.fedcommunities.org](http://www.fedcommunities.org). We encourage you to browse through this site and to contact your regional office if you would like additional information on any of these items.

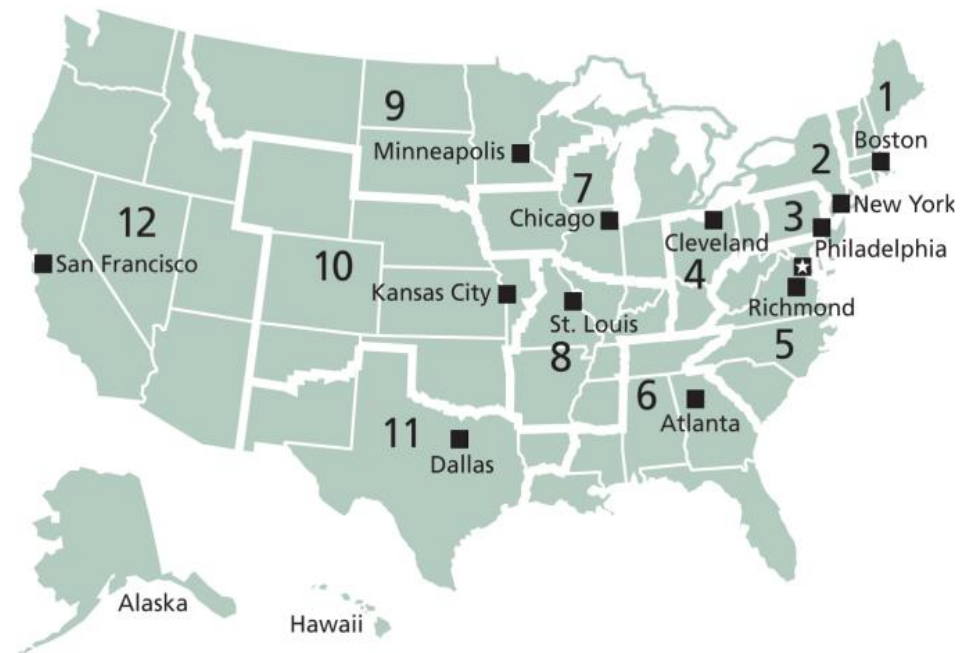
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# Community Development

The Community Development (CD) function within the Federal Reserve System – consisting of individual departments at each of the twelve Federal Reserve Banks as well as at the Board of Governors – promotes economic growth and financial stability for low- and moderate-income (LMI) communities and individuals through a range of activities, including:

- **Convening stakeholders**, including practitioners, financial institutions, nonprofits, governmental agencies, and the philanthropic and private sectors,
- **Conducting and sharing research** to examine economic challenges facing low- and moderate-income communities and attendant policy implications; and,
- **Identifying emerging issues.**



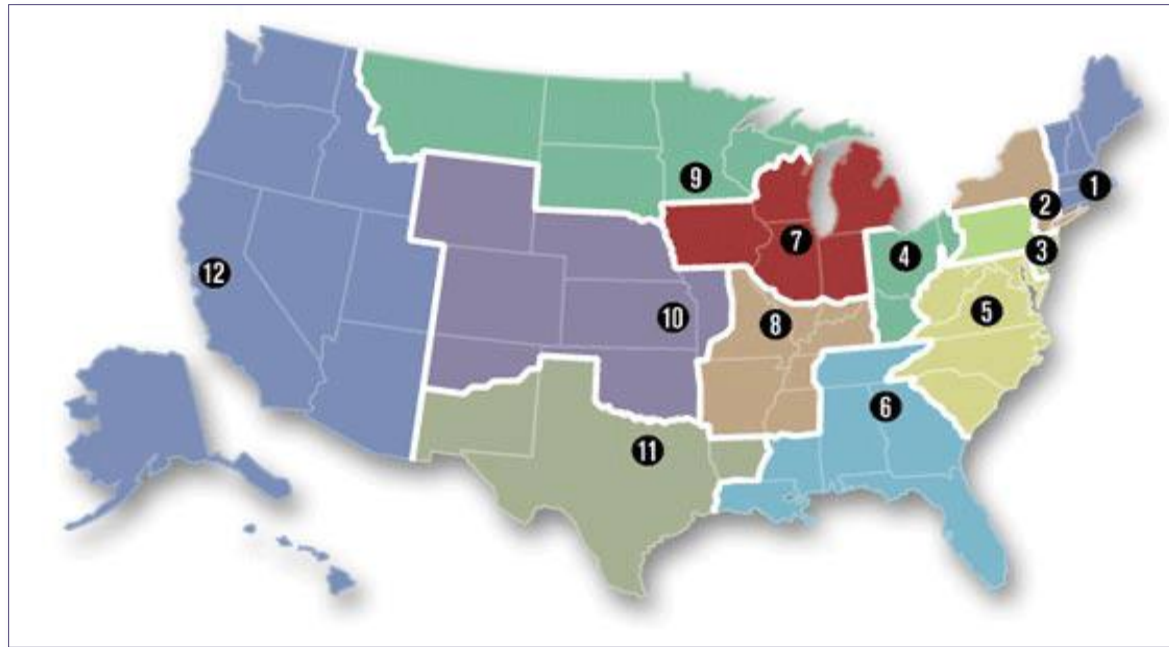
# The Next Frontier of Community Development: Pay for Success and Social Impact Bonds

## **Ian Galloway**

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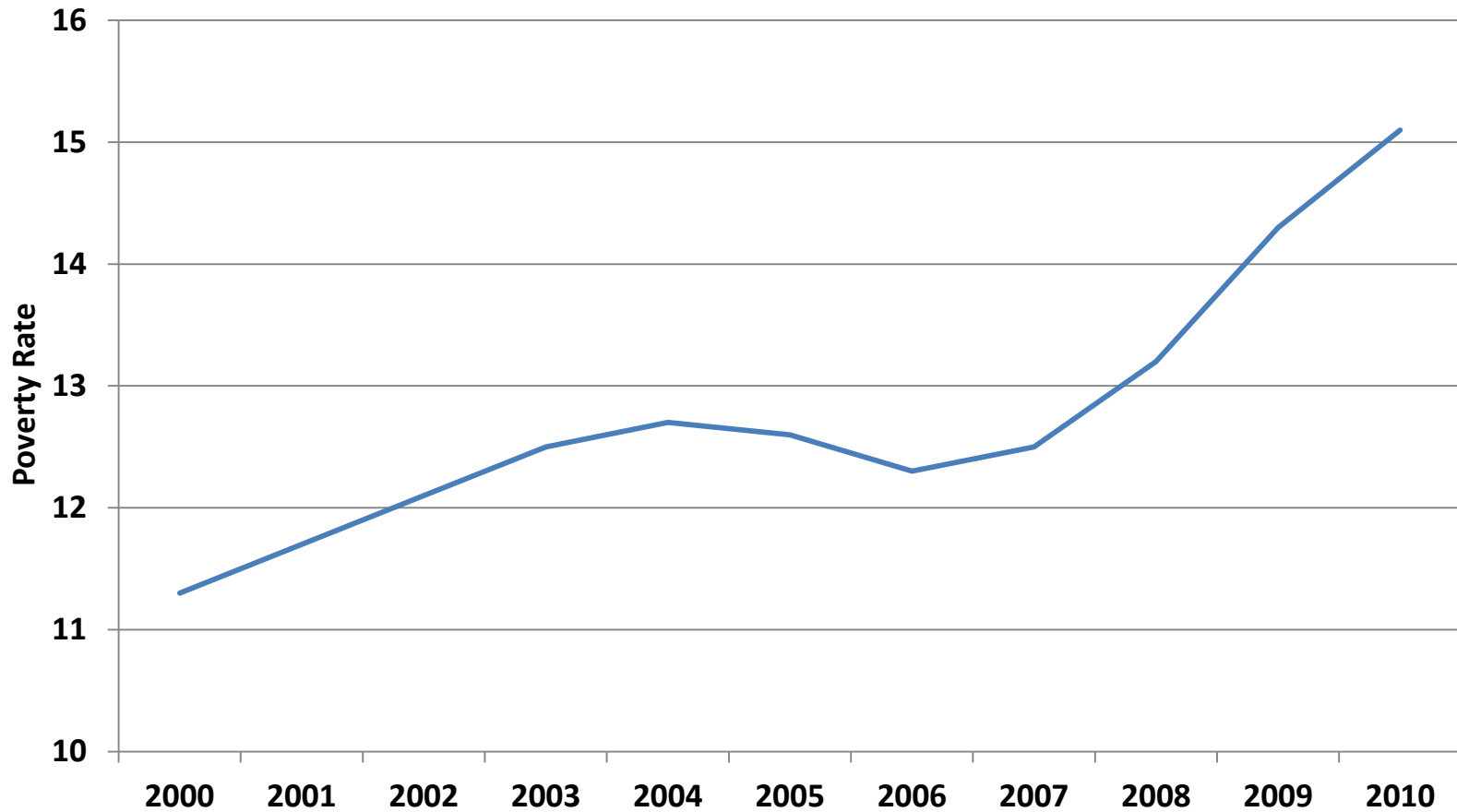
# Why the Federal Reserve?



Source: Connecting Communities: <https://www.stlouisfed.org/bsr/connectingcommunities/index.cfm?proc=about&act=fedcomdev>

# Winning Battles but Losing the War

Percent of total population below poverty level (Annual)



Source: U.S. Census Bureau

# Poverty Worst in Decades by Some Measures

	In 2010	Highest...
Share of overall population in poverty (earning below \$22,314 for a family of four)	15.1%	Since 1993
Number of people in poverty	46.2 million	On record*
Share of people below half of the poverty line	6.7%	On record*
Share of poor people below half of the poverty line	44.3%	On record*
Share of children in poverty	22.0%	Since 1993
Share of adults aged 18 to 64 in poverty	13.7%	Since 1966
Share of people living in suburbs in poverty	11.8%	Since 1967

Source: Center on Budget and Policy Priorities, U.S. Census Bureau



# Community Development Needs to Evolve

- Rebuilding neighborhoods necessary but not sufficient
- Human capital development key to solving poverty
  - Challenge: Current funding sources oriented towards real estate development not human capital development
  - Solution: Create new funding sources that pay for successful social outcomes (Pay for Success)

# Presentation Outline

- What is Pay for Success (PFS)?
- Examples of PFS
- What are Social Impact Bonds (SIBs)?
  - Example #1: Early Childhood Education in Salt Lake City
  - Example #2: Improving Childhood Outcomes in South Carolina
  - Example #3: Supportive Housing in Portland, OR
- Benefits of Pay for Success
- Pitfalls of Pay for Success

# What Is Pay for Success?

- Financing structure to capture downstream government savings to fund upstream community investments.



# What Is Pay for Success?, continued

- Performance-based contracting
  - Government commits funding for successful outcomes (i.e., increased high school graduation rates).
  - Independent impact auditor evaluates program effectiveness.
  - Government only “pays for success”.

# What Is Pay for Success?, continued

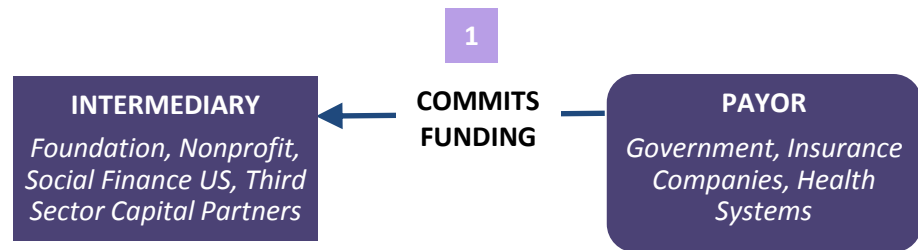
- Service provider financing
  - Private investors fund service provider operating costs in exchange for a share of the success payment
  - Financing terms are based on:
    - Difficulty of achieving success
    - Track record of the service provider
    - Length of the contract
  - Investors bear the risk that success won't be achieved (and that the government payment won't be triggered)

# Examples of Pay for Success

- Prize-based Philanthropy
- Low Income Housing Tax Credit
- Tax Increment Financing
- Energy Efficiency Financing
- Human Capital Performance Bond
- SIB

# What Are Social Impact Bonds (SIB)?

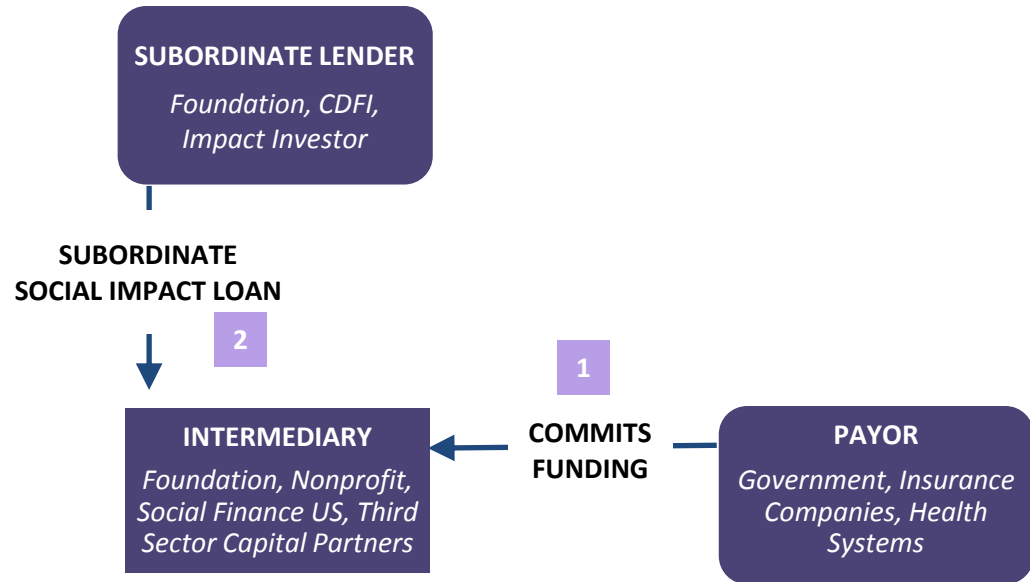
## Basic Transaction Structure



Source: Federal Reserve Bank of San Francisco

# What Are Social Impact Bonds (SIB)?

## Basic Transaction Structure

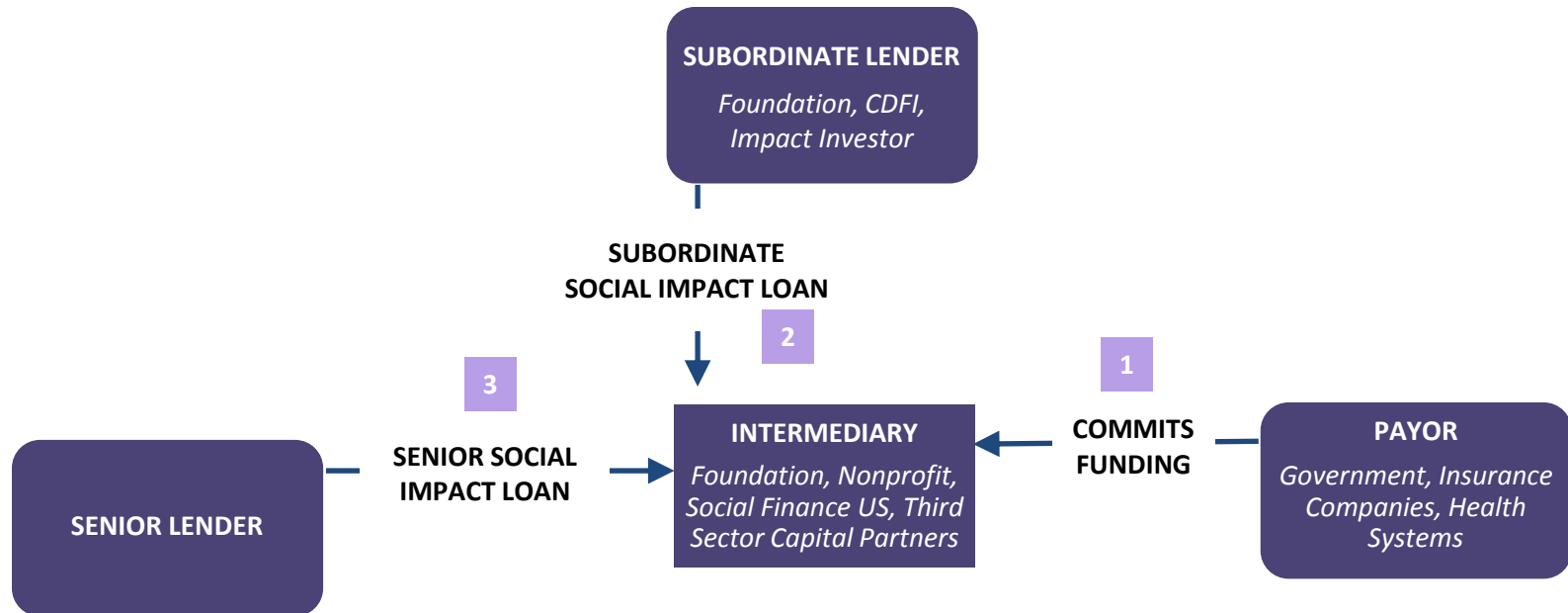


Source: Federal Reserve Bank of San Francisco



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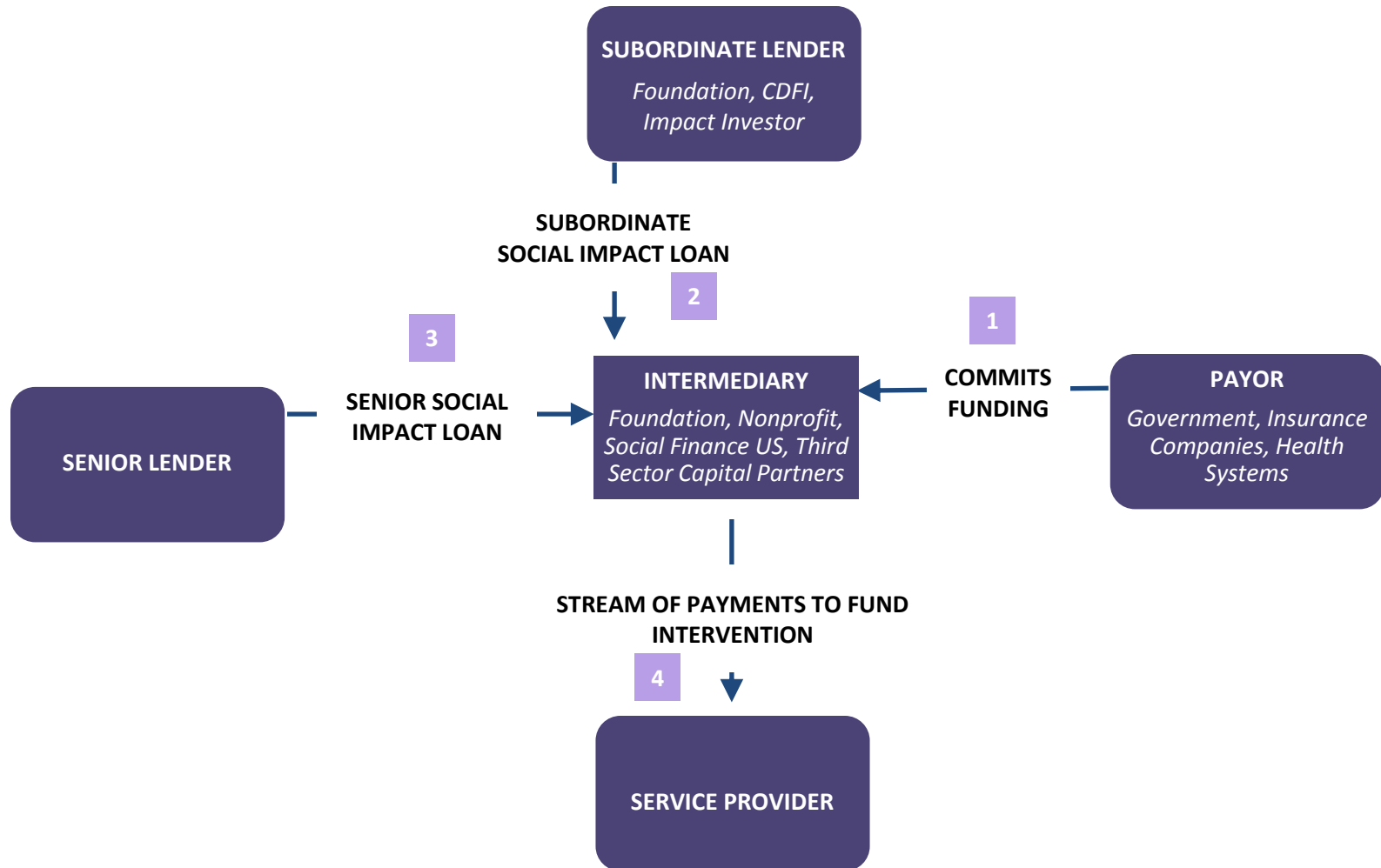
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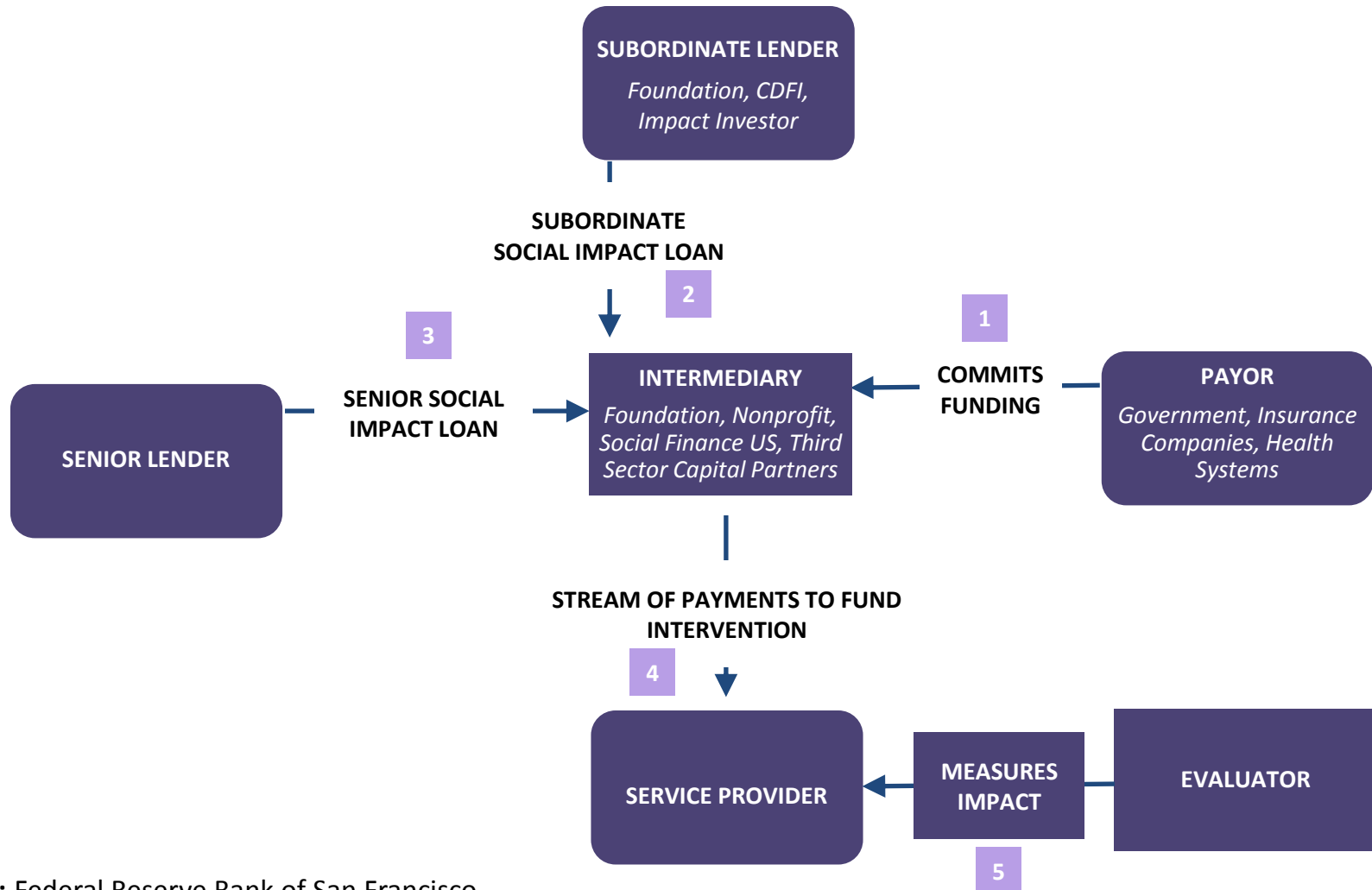
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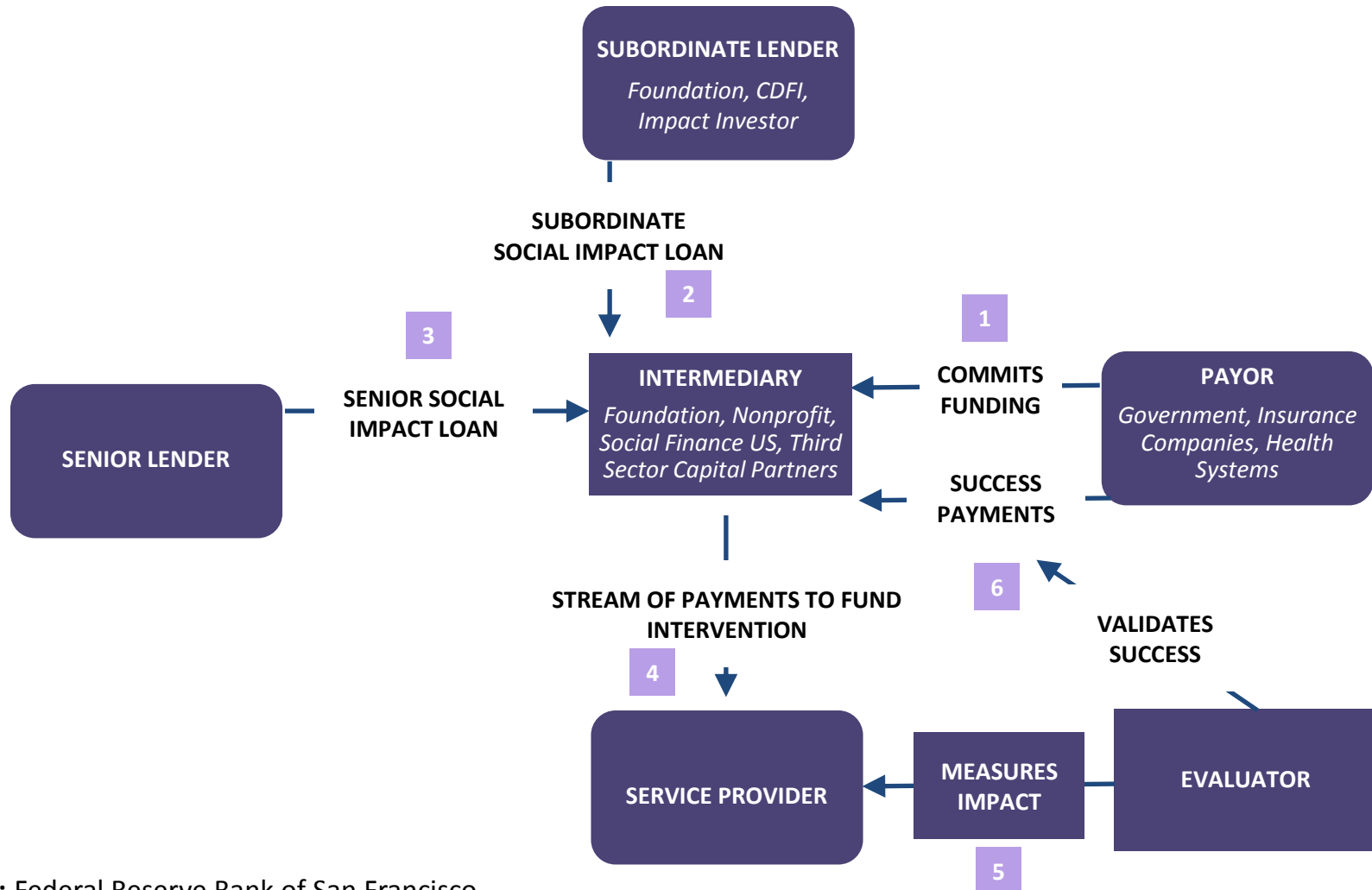
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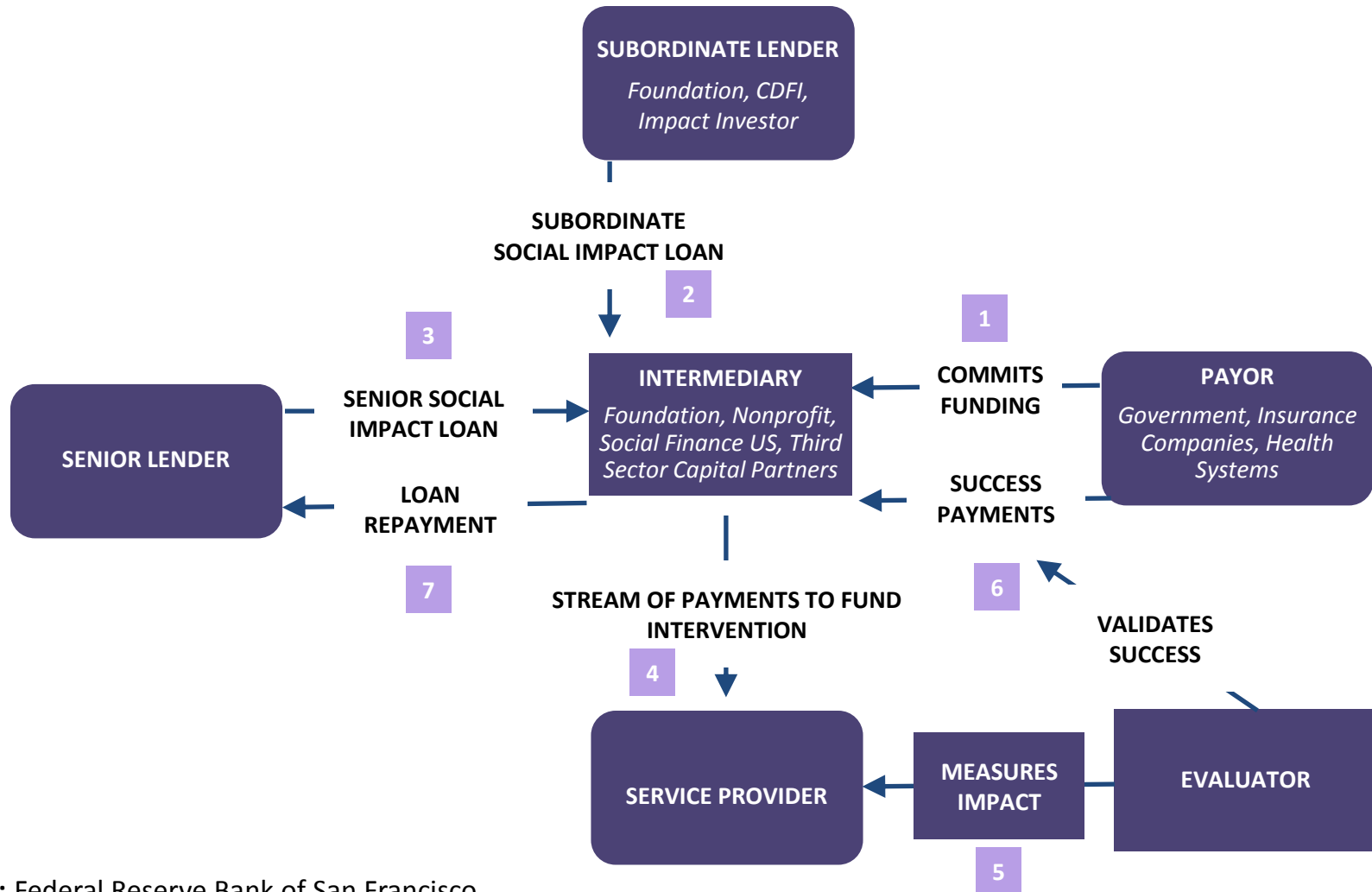
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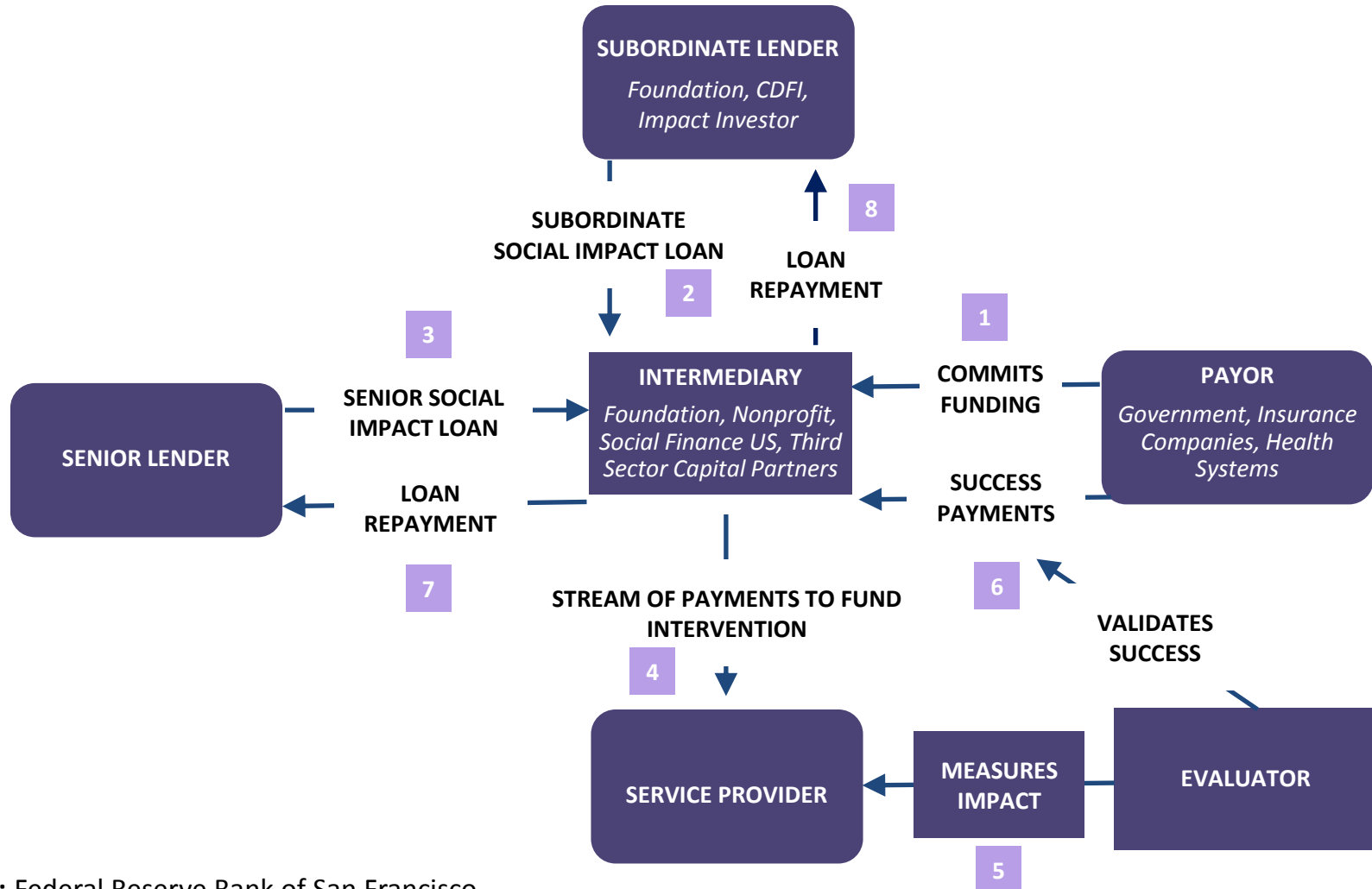
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# What Are Social Impact Bonds (SIB)?

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# SIB Example #1: Early Childhood Education in Salt Lake City

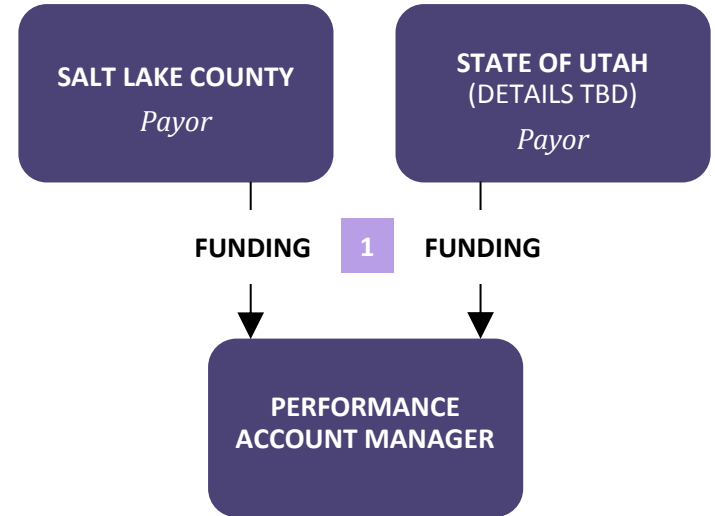
- 3,500 low-income 3 and 4 year-olds will be enrolled in the Utah High Quality Preschool Program and have their academic progress tracked from K-6 grade.
- Children participating in the program will be given the Peabody Picture Vocabulary Test to determine how many, absent high impact preschool, would likely require special education services in the future.

# SIB Example #1: Early Childhood Education in Salt Lake City, continued

- \$4.6 million senior loan from Goldman Sachs to United Way of Salt Lake.
- \$2.4 million subordinate loan from J.B. Pritzker Foundation to United Way of Salt Lake.
- United Way of Salt Lake oversees implementation of the project and manages investor repayments.
- Every year of avoided special education generates a success payment of \$2,470/child plus 5 percent interest to Goldman Sachs and J.B. Pritzker Foundation until senior and subordinate debt is fully repaid (\$1,040/child thereafter).

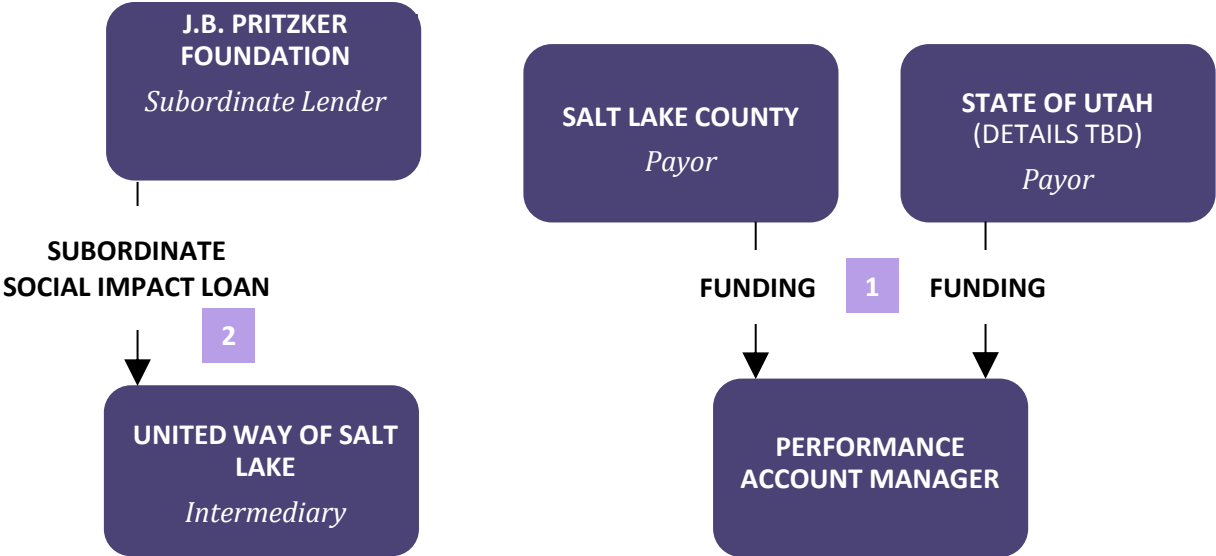


# Early Childhood Education in Salt Lake City: Transaction Structure of the Utah SIB



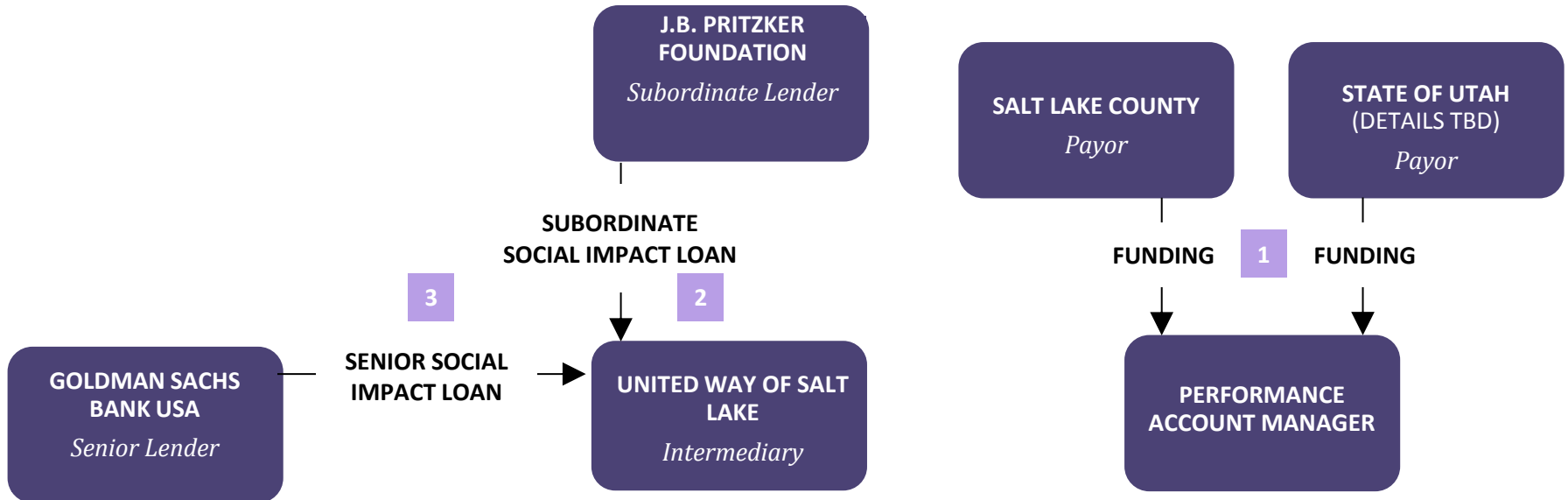
Source: Goldman Sachs Bank USA and the Federal Reserve Bank of San Francisco

# Early Childhood Education in Salt Lake City: Transaction Structure of the Utah SIB



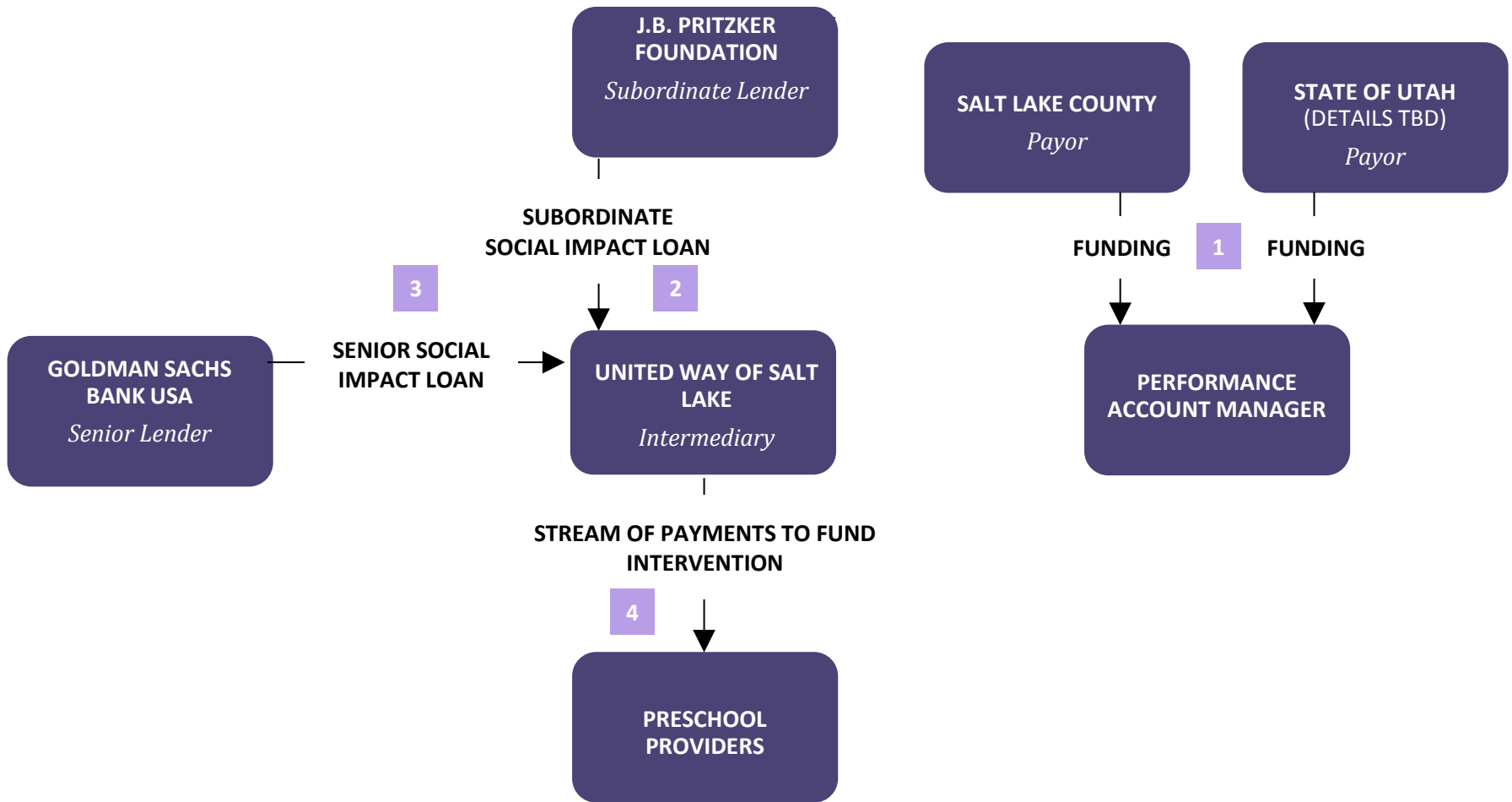
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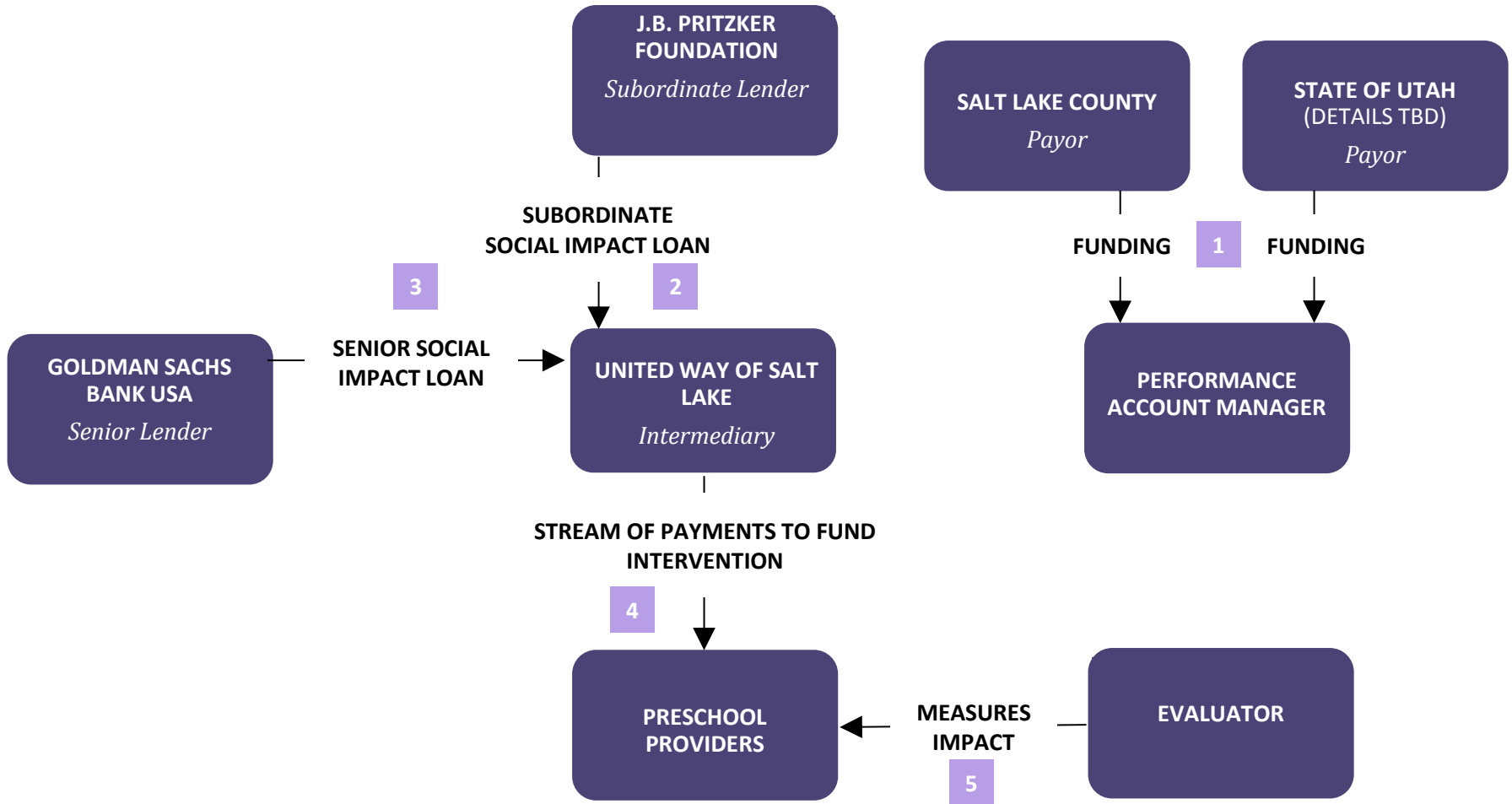
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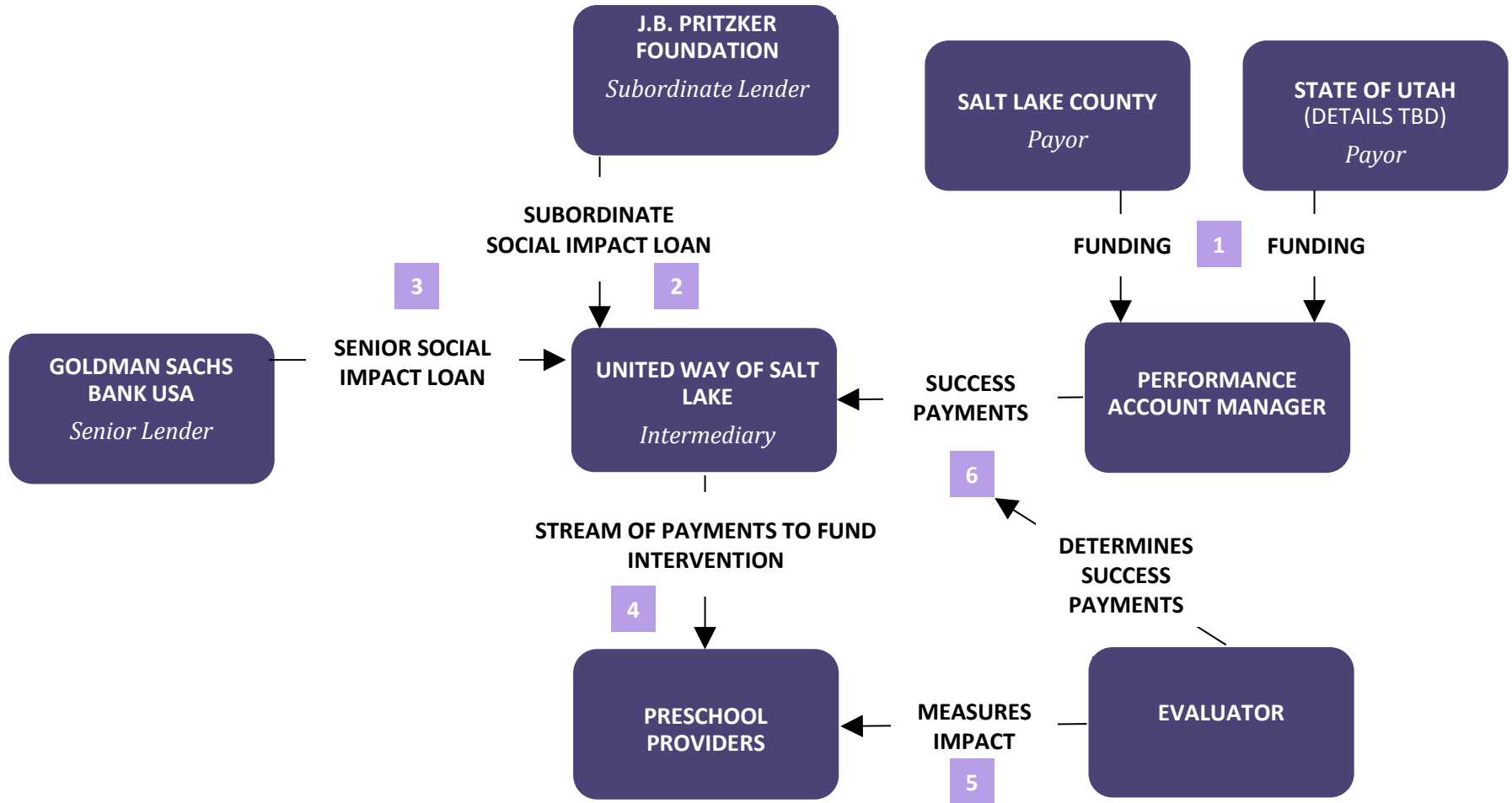
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# Early Childhood Education in Salt Lake City: Transaction Structure of the Utah SIB



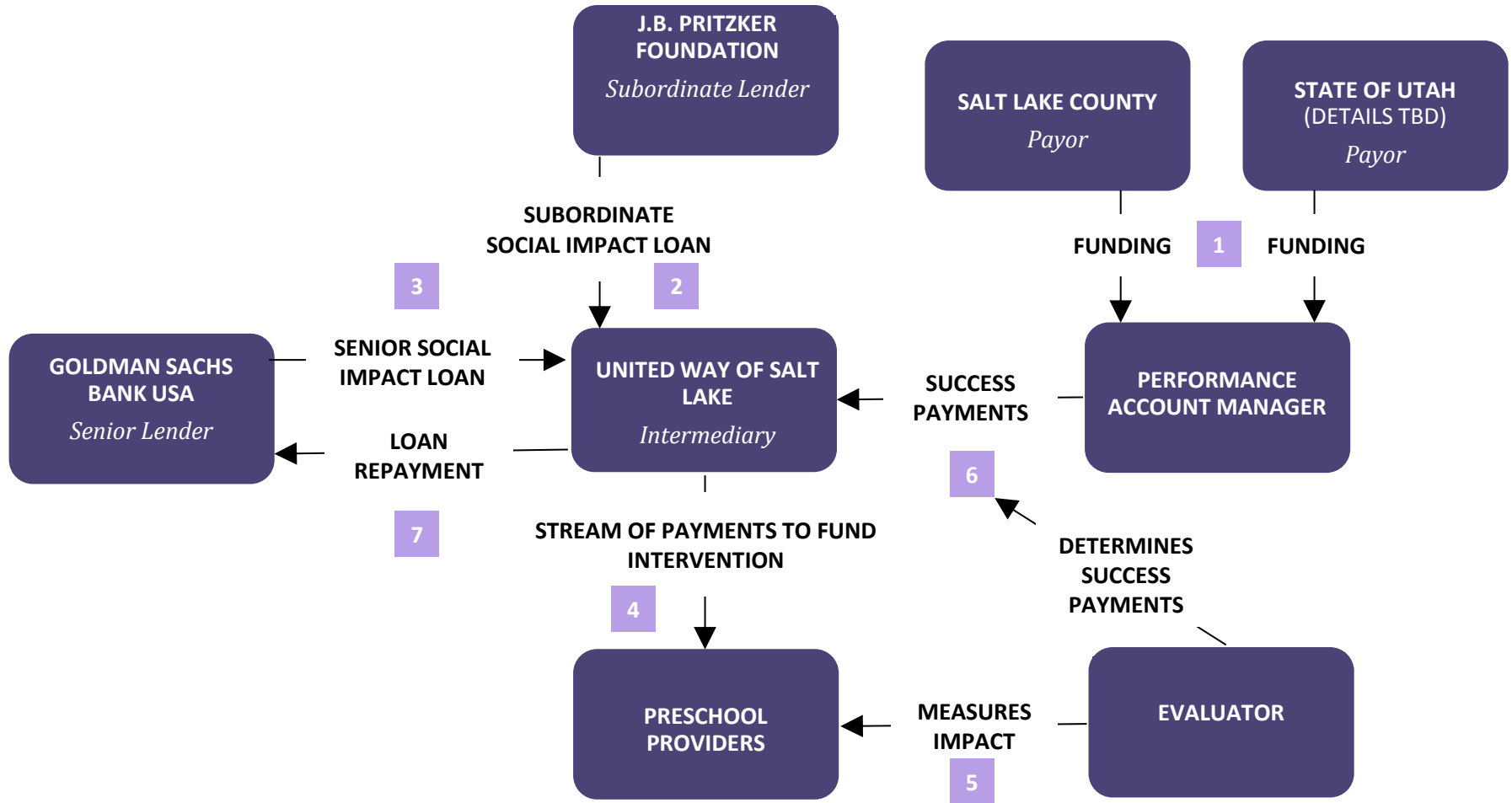
Source: Goldman Sachs Bank USA and the Federal Reserve Bank of San Francisco

# Early Childhood Education in Salt Lake City: Transaction Structure of the Utah SIB



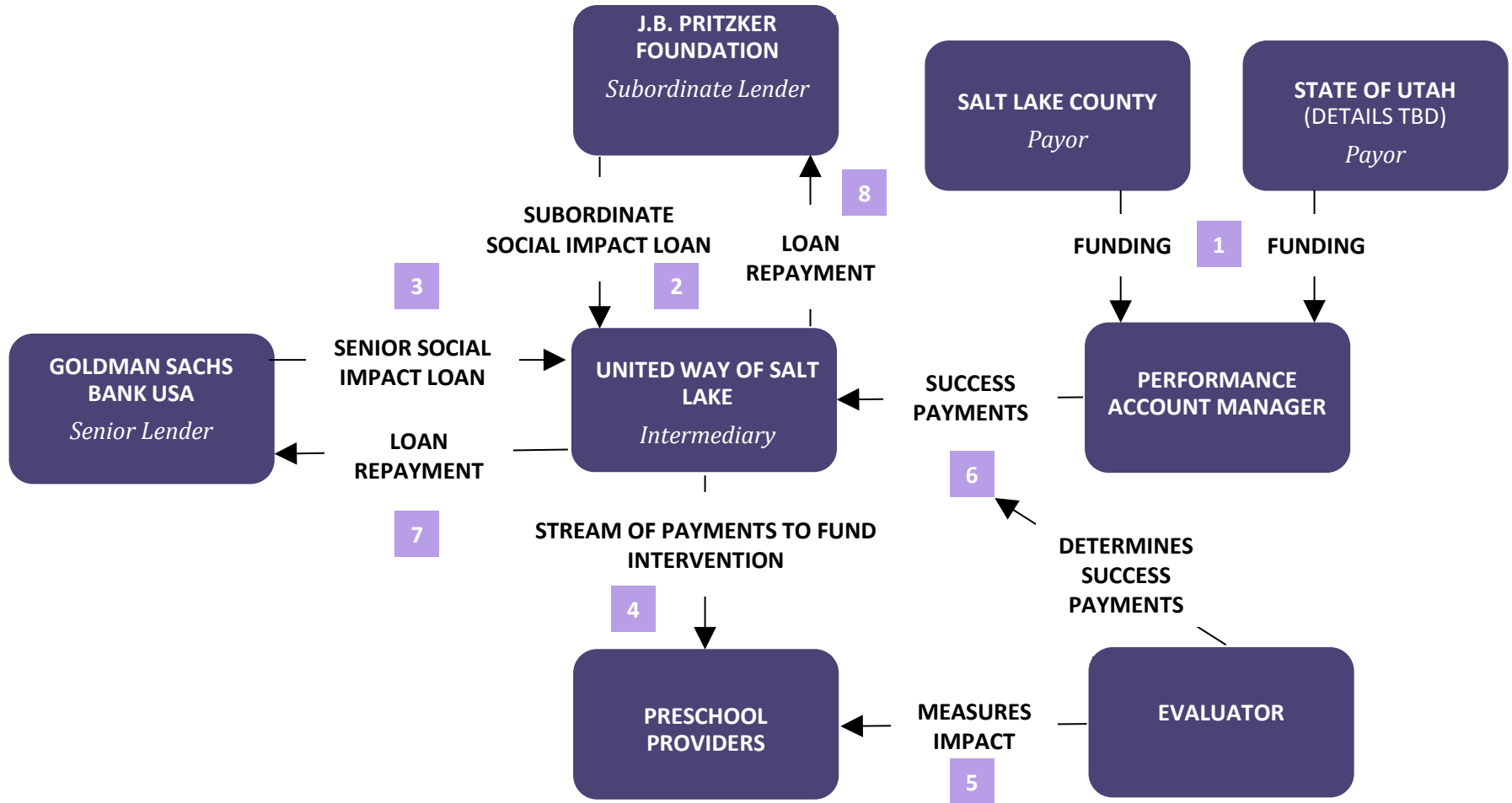
Source: Goldman Sachs Bank USA and the Federal Reserve Bank of San Francisco

# Early Childhood Education in Salt Lake City: Transaction Structure of the Utah SIB



Source: Goldman Sachs Bank USA and the Federal Reserve Bank of San Francisco

# Early Childhood Education in Salt Lake City: Transaction Structure of the Utah SIB



Source: Goldman Sachs Bank USA and the Federal Reserve Bank of San Francisco



# SIB Example #2: Improving Childhood Outcomes in South Carolina

- South Carolina ranks 45th in overall child well-being.

<p><b>Economic Well-Being</b></p> <ul style="list-style-type: none"><li>• Children in poverty</li><li>• Children with a high housing cost burden</li><li>• Children with parents lacking secure employment</li><li>• Teens not in school and not working</li></ul>	<p><b>Health</b></p> <ul style="list-style-type: none"><li>• Low-birth-weight babies</li><li>• Child and teen deaths/100,000</li><li>• Children without health insurance</li><li>• Teens who abuse alcohol or drugs</li></ul>
<p><b>Education</b></p> <ul style="list-style-type: none"><li>• Children not attending preschool</li><li>• Eighth graders not proficient in math</li><li>• Fourth graders not proficient in reading</li><li>• High school students not graduating on time</li></ul>	<p><b>Family &amp; Community</b></p> <ul style="list-style-type: none"><li>• Children in single-parent families</li><li>• Children living in high-poverty areas</li><li>• Children in families where the household head lacks a high school diploma</li><li>• Teen births per 1,000</li></ul>

Source: "Using Pay for Success Financing to Improve Outcomes for South Carolina's Children," Institute for Child Success

# South Carolina SIB Intervention: Nurse-Family Partnership

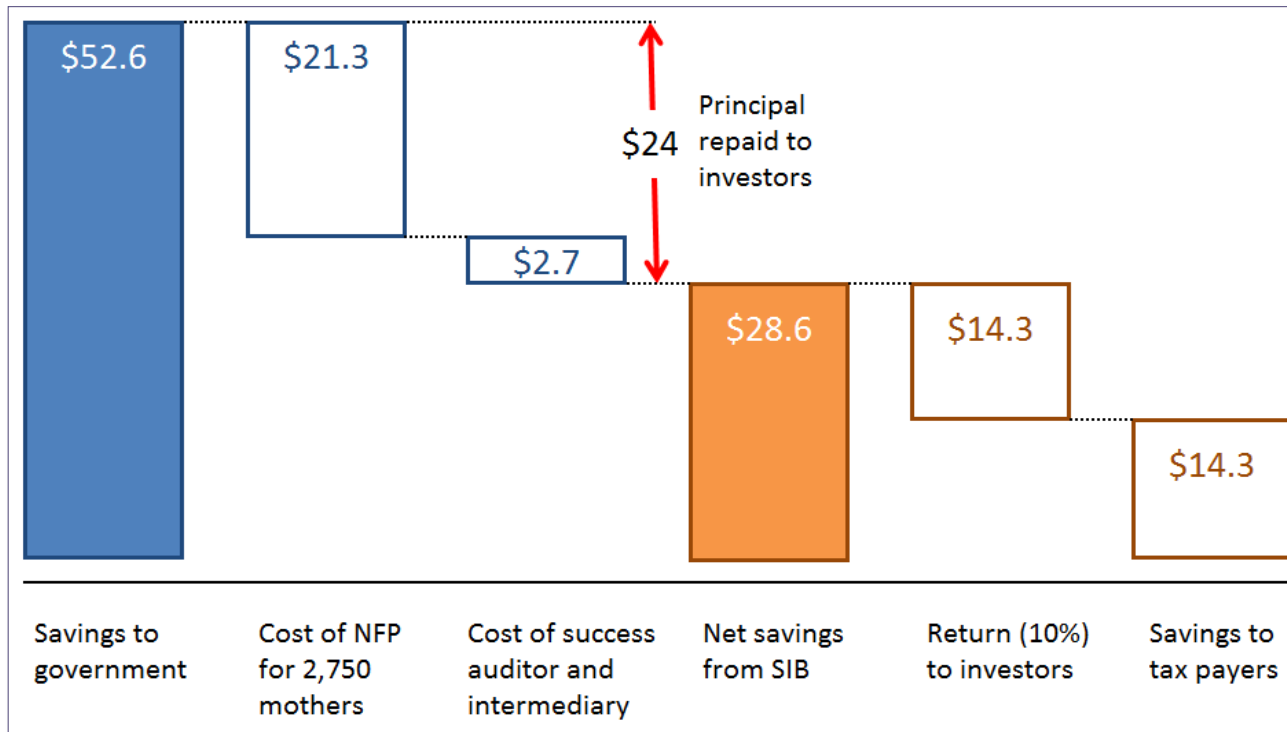
- Nurse-Family Partnership targets low-income mothers' first pregnancies with home visitation by registered nurses from pregnancy through age 2.
- Home visiting programs have been shown to improve childhood outcomes in a number of areas:
  - Fewer premature births and low-birth-weight babies
  - Improved child health and development
  - Reduced child maltreatment
  - Improved maternal self-sufficiency
  - Children better prepared for kindergarten

# South Carolina SIB Savings: Government Cost Avoidance

- A successful childhood outcome saves government \$19,120 over first 18 years of life.
- Breakdown of cost savings by public budget area:
  - Medicaid (64 percent)
  - Food stamps (15 percent)
  - Police, adjudication, and sanctioning (6 percent)
  - Child protective services (5 percent)
  - Special education (4 percent)
  - TANF (4 percent)

# South Carolina SIB: Cost / Benefit of Success

Illustrative Six-Year Nurse-Family Partnership SIB (millions)



Source: "Using Pay for Success Financing to Improve Outcomes for South Carolina's Children," Institute for Child Success

# Using PFS for Community Development?

## SIB Example #3: Supportive Housing

- The Bud Clark Commons provide apartments and services for homeless residents in Portland, OR.
- Offer a full spectrum of services with an emphasis on:
  - The integration of health and wellness services within a supportive housing program.
  - The “harm reduction model,” which prioritizes housing for the most vulnerable applicants and does not screen out residents who are struggling with addiction.
- Applicants must earn below 35 percent Account Management Information to qualify.
- Apartments are independent living and include full kitchens and baths.

# Bud Clark Commons: Health Care Costs Savings

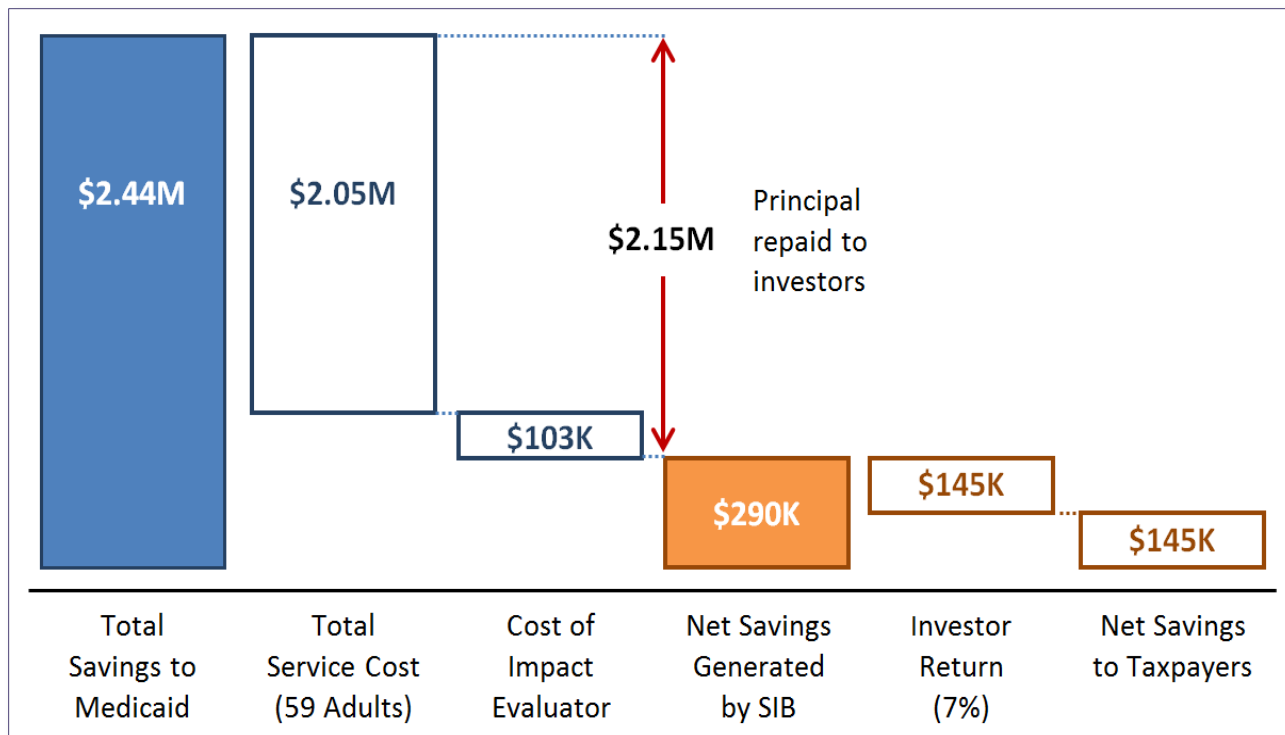
## Cost Savings to Medicaid (Per person, 2013)

Services Billed to Medicaid	Year Before Move-In	1 <sup>st</sup> Year After Move-In	2 <sup>nd</sup> Year After Move-In	3 <sup>rd</sup> Year After Move-In	TOTAL SAVINGS AFTER 3 YEARS
Inpatient Behavioral Health	\$816	\$132	\$204	\$168	\$1,944
Inpatient Physical Health	\$6,924	\$3,696	\$5,976	\$2,256	\$8,844
Outpatient Behavioral Health	\$2,292	\$1,884	\$1,968	\$2,004	\$1,020
Emergency Department	\$2,520	\$1,044	\$696	\$300	\$5,520
Outpatient Primary Care	\$828	\$732	\$384	\$348	\$1,020
Outpatient Labs & Radiology	\$1,356	\$648	\$348	\$384	\$2,688
Outpatient Specialty	\$6,096	\$684	\$684	\$996	\$15,924
Pharmacy	\$1,380	\$1,260	\$912	\$1,308	\$660
Other	\$1,872	\$708	\$792	\$396	\$3,720
<b>TOTAL ANNUAL COST</b>	<b>\$24,084</b>	<b>\$10,788</b>	<b>\$11,964</b>	<b>\$8,160</b>	<b>\$41,340</b>

Source: "Integrating Housing & Health," Center for Outcomes Research and Education (2014)

# Bud Clark Commons: PFS Project Cost / Benefit Analysis

**Illustrative Three-Year PFS Project (Serving 59 People)**



Source: "Integrating Housing & Health" (2014) and Federal Reserve Bank of San Francisco

# Benefits of Pay for Success

- Encourages social sector innovation
  - Outcomes-based payments mean nonprofits “sell” success
  - Entrepreneurship necessary to compete in the marketplace
- Promotes evidence-based policy
  - Moves us from inputs/outputs to outcomes
  - Government only pays for what works



# Benefits of Pay for Success, continued

- Builds on success of existing public/private investment model
  - \$80B in Community Reinvestment Act capital, public programs, and private funds
  - Low Income Housing Tax Credit example
- Supports holistic community development
  - Success of community quarterback model but no investment vehicle
  - Harlem Children's Zone, Purpose Built, Strive, Neighborhood Centers Inc., Magnolia Place, Local Initiatives Support Corporation New Communities Program

# Pitfalls of Pay for Success

- Legitimacy of data collection and use
  - Pressure on all sides to fudge data
- Tying savings to payments
  - Hard to extract savings from public budgets (may reduce prison overcrowding but hard to close prisons)
  - Continuing need to fund prevention
- Government capacity and appropriations risk
  - Is government ready for this?
  - Underwriting appropriations risk may make deals impossible
- Ethical considerations
  - The most savings may not equal the most good
  - Perverse incentives, careful oversight needed

## Questions?

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1. Email us at: [communities@stls.frb.org](mailto:communities@stls.frb.org).
2. Type your question into the chat box of the webinar.

# Wrap-Up/Closing

Thank you to today's presenters and to all participants for joining this session.

## Next steps:

- All session materials are available on our web site and in the next few days we will be posting an audio file of today's session.
- If you have topical suggestions for future sessions, or any questions about this program, please feel free to contact us at [communities@stls.frb.org](mailto:communities@stls.frb.org)
- Information about future sessions will be posted on our website along with archived materials from past sessions:  
[www.stlouisfed.org/connectingcommunities/](http://www.stlouisfed.org/connectingcommunities/)

# Related Resources



- In connection with this session, you can find a variety of additional resources, available at **www.fedcommunities.org**. It provides an array of practical resources to help you in your role as a community development professional, whether you work involves supporting people, places, the practice of community development, or small business development.
- Register now for our next session on August 14<sup>th</sup>: [Investing in the Frontlines: Improving Employment Outcomes of Direct Caregivers in the Changing Healthcare Industry](#)
  - Presented by Steven Dawson, Strategic Advisor at Paraprofessional Healthcare Institute; Jan Hunter, CareerSTAT Director at National Fund for Workforce Solutions; and Steven Shepelwich, Senior Community Development Advisor at the Federal Reserve Bank of Kansas City