

FINANCING HOMELESSNESS PREVENTION PROGRAMS
WITH SOCIAL IMPACT BONDS

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Introduction

Complicated new financial instruments have attracted mostly negative press since the financial collapse of 2008.¹ In the nonprofit sector, however, the social impact bond (“SIB”) is one complex financial novelty that is garnering a lot of positive attention.² While the concept of SIBs remains mostly theoretical in the United States, it has picked up a few heavyweight supporters along the way, including President Barack Obama and Kennedy School economist Jeffrey Liebman.³

Social impact bonds are structured to allow private investment capital to flow into intervention programs that produce cost-saving social outcomes.⁴ For example, a SIB might fund a three-year program that teaches vocational skills to veterans to reduce their

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¹ See, e.g., Alex Blumberg, *How Credit Default Swaps Spread Financial Rot*, NAT’L PUB. RADIO, Oct. 30, 2008, <http://www.npr.org/templates/story/story.php?storyId=96333239> (explaining how complicated credit default swap arrangements brought down Lehman Brothers).

² See, e.g., Andrew Wolk, *What Social Impact Bonds Mean for Nonprofits and Performance Measurement*, ROOT CAUSE, Oct. 25, 2011, <http://rootcause.org/blog/what-social-impact-bonds-mean-nonprofits-and-performance-measurement> (discussing potential positive implications of the SIB model).

³ *Paying for Success*, WHITE HOUSE OFFICE OF MGMT. & BUDGET, <http://www.whitehouse.gov/omb/factsheet/paying-for-success> (last visited Apr. 3, 2012); Jeffrey B. Liebman, *Social Impact Bonds: A Promising New Financial Model to Accelerate Social Innovation and Improve Government Performance*, CTR. FOR AM. PROGRESS, 1 (Feb. 2011), available at http://www.americanprogress.org/issues/2011/02/pdf/social_impact_bonds.pdf.

⁴ Tracy Palandjian & Steve Goldberg, *Bringing Social Impact Bonds to Massachusetts: Response to Request for Information About Social Impact Bonds by the Commonwealth of Massachusetts*, SOC. FIN., 4 (June 10, 2011) (available with Social Finance upon request).

use of safety-net government services like welfare. SIBs differ from charitable donations in that bondholders are repaid their investment plus a premium by the government if the service provider meets certain predetermined program targets. In the example above, the target might be a 15 percent increase in stable employment for veterans relative to a control group. Under the SIB funding structure, the government is willing to repay the investor plus a premium upon successful completion of the program because, in theory, the premium represents only a fraction of the savings realized by decreased dependence on taxpayer-funded safety-net programs.

This article explores the potential that SIBs have to fight homelessness in Massachusetts and throughout the nation. Massachusetts will soon become the first state to translate the theory of SIBs into practice, as it is in the midst of a competitive procurement process to identify and contract with service providers and intermediaries capable of piloting a SIB-funded program targeting the chronically homeless.⁵

Part I of this article outlines the theory and practice of SIB funding structures generally. Part II then examines the problem of homelessness in Massachusetts, the efficacy of existing homelessness prevention programs and the status of the SIB pilot initiative. Finally, Part III identifies and addresses challenges to the successful implementation of SIB-funded programs.

⁵ *Request for Response (RFR): Social Innovation Financing for Homelessness—Service Providers*, COMMONWEALTH OF MASS., EXEC. OFFICE OF ADMIN. & FIN. (Jan. 18, 2012), available at <https://www.ebidsourcing.com/viewDoc?doValidateToken=false&docPath=%2FPublic%2FSolicitations%2F127964%2F00005%2FRFR%2FRFRHomelessnessServiceProvidersFINAL.doc> (seeking service providers); *Request for Response (RFR): Social Innovation Financing for Homelessness—Intermediaries*, COMMONWEALTH OF MASS., EXEC. OFFICE OF ADMIN. & FIN. (Jan. 18, 2012), available at <https://www.ebidsourcing.com/viewDoc?doValidateToken=false&docPath=%2FPublic%2FSolicitations%2F127963%2F00004%2FRFR%2FRFRHomelessnessIntermediariesFINAL.doc> (seeking intermediaries) [hereinafter collectively cited as “The RFRs”].

I. Social Impact Bonds: Theory and Practice

A. Background

The concept of SIBs arose as a potential solution to problems faced by various groups connected to the social service sector. Nonprofit organizations suffer a constant operational strain from insufficient and undependable capital streams.⁶ Meanwhile, governmental efforts to improve social outcomes are similarly frustrated by funding deficiencies, lack of expertise and risk aversion to untested approaches.⁷ In addition, many taxpayers resent the misuse and mismanagement of their limited resources.⁸ Finally, facing a lack of promising financial opportunities to promote positive social outcomes, impact investors have sought newer and better options for funding charitable ventures.⁹

In response to these needs, “Social Finance was set up in 2007 to help build a social investment market in the UK.”¹⁰ The organization was interested in finding innovative ways to deliver capital to a staggering English nonprofit sector.¹¹ In 2008, Social Finance spoke with current board members David Robinson and Peter Wheeler about “whether preventative activity could be funded from savings made in acute spending as a result of successful preventative work.”¹² This critical question sowed the seeds that eventually produced SIBs.

⁶ Emilie Goodall & John Kingston, *Access to Capital*, SOC. FIN., 4–6 (Sept. 2009), available at http://socialfinanceus.org/sites/socialfinanceus.org/files/Venturesome_Access_to_Capital_0909.pdf

⁷ Leibman, *supra* note 3, at 7.

⁸ See Katie Gilbert, *The Latest in Socially Conscious Investing: Human Capital Performance Bonds*, INST. INVESTOR, Jan. 10, 2012, <http://www.institutionalinvestor.com/Popups/PrintArticle.aspx?ArticleID=2958534>.

⁹ See Steve Goldberg, *Robust Intermediaries Key to Social Impact Bond Success*, TACTILE PHILANTHROPY, Aug. 22, 2011, available at <http://www.tacticalphilanthropy.com/2011/08/robust-intermediaries-key-to-social-impact-bond-success>.

¹⁰ *How We Work*, SOC. FIN., <http://www.socialfinance.org.uk/about/how-we-work> (last visited Apr. 3, 2012).

¹¹ *Id.*

¹² Emily Bolton & Louise Savell, *Towards a New Social Economy: Blended Value Creation Through Social Impact Bonds*, SOC. FIN., 3 (Mar. 2010), http://www.socialfinance.org.uk/sites/default/files/Towards_A_New_Social_Economy_web.pdf.

With help from renowned law firm Allen & Overy, Social Finance began developing what is now called the social impact bond.¹³ In 2010, it launched the first SIB-funded intervention program; the purpose of the program was to reduce the reoffending rates of prisoners sentenced to twelve months or less at the Peterborough prison in England.¹⁴ A contract was signed with the UK Ministry of Justice in March 2010 and the pilot program began in September 2010.¹⁵ The pilot recently completed its first year, but it is still too early to measure whether the program has successfully reduced reoffending rates among the Peterborough population.¹⁶

The Peterborough pilot identified short-term convicts as a particularly vulnerable group; once released, 60 percent of these offenders are convicted of at least one new offense in the year following their release.¹⁷ Reducing this recidivism rate would generate huge cost savings, mostly from decreased incarceration costs.¹⁸ Social Finance saw this as an opportunity to implement the SIB model because no single organization “has statutory responsibility for this group of offenders once they leave prison.”¹⁹

Under the pilot program, three cohorts of 1,000 prisoners each receive a set of interventions from four principal service providers, collectively managed under the One* Service.²⁰ Pre-release, participants are involved in “[a] series of meetings and workshops . . . to inform [them] of the opportunities for support post-release.”²¹ Some service providers focus on the immediate needs of

¹³ *Id.*

¹⁴ Alisa Helbitz et al., *Reducing Reoffending Among Short Sentenced Male Offenders from Peterborough Prison*, SOC. FIN., 4 (Nov. 2011), http://www.socialfinance.org.uk/sites/default/files/sf_peterborough_one_year_on.pdf.

¹⁵ Emily Bolton & Jenna Palumbo, *Peterborough Social Impact Bond*, SOC. FIN., 2 (2011), http://www.socialfinanceus.org/sites/socialfinanceus.org/files/SF_Peterborough_SIB_0.pdf.

¹⁶ Helbitz et al., *supra* note 14, at 2.

¹⁷ *Id.* at 6.

¹⁸ See *Request for Response (RFR): Pay for Success Contracting for Youth—Service Providers*, COMMONWEALTH OF MASS., EXEC. OFFICE OF ADMIN. & FIN. (Jan. 18, 2012), available at <https://www.ebidsourcing.com/viewDoc?doValidateToken=false&docPath=%2FPublic%2FSolicitations%2F127969%2F00004%2FRFR%2FRFRYouthServiceProvidersFINAL.doc>.

¹⁹ Helbitz et al., *supra* note 14, at 6.

²⁰ *Id.* at 7.

²¹ *Id.* at 10.

offenders both before and after release, such as “accommodation, medical services, family support, employment, training, benefits and financial advice.”²² Once an offender’s short-term needs are satisfied—usually about four months after release—a volunteer from one of the providers is assigned to address that offender’s longer-term needs.²³

Seventeen investors provided the One* Service with £5 million of operational funding, to be drawn out evenly over six years.²⁴ Each successive cohort of 1,000 prisoners will be evaluated independently for success, so the program needs to run for about three years before evaluating the first cohort.²⁵ Investors are eligible for payments based on the individualized successes of each group if a minimum of a 10 percent recidivism reduction is reached for that group.²⁶ Otherwise, investors must wait until the end of the eight year program period and “[i]f a reduction in reoffending of 7.5 [percent] is achieved across all 3,000 offenders, investors will receive a payment.”²⁷ Failure to reach the 7.5 percent reduction target over the contract period will result in 100 percent investor losses.²⁸

Investor payouts vary with the relative success of the program.²⁹ For example, reduction of reconviction rates by 10 percent in all three cohorts will result in a 7.5 percent annualized return over the eight-year contract period.³⁰ Returns are even higher if the program is exceptionally successful, capped at roughly a 13 percent annual return.³¹ If program targets are achieved, the UK’s Big Lottery Fund will be responsible for investor payouts.³²

²² *Id.* at 9.

²³ *Id.*

²⁴ Lenny Roth, *Social Impact Bonds*, NSW PARLIAMENTARY LIBRARY RESEARCH SERV., 4 (Dec. 17, 2011), available at [http://www.parliament.nsw.gov.au/prod/parlment/publications.nsf/key/SocialImpactBonds/\\$File/e-brief.social+impact+bonds.pdf](http://www.parliament.nsw.gov.au/prod/parlment/publications.nsf/key/SocialImpactBonds/$File/e-brief.social+impact+bonds.pdf).

²⁵ *Id.* at 5.

²⁶ *Id.*

²⁷ *Id.*

²⁸ Bolton & Palumbo, *supra* note 15, at 1.

²⁹ Roth, *supra* note 24, at 5.

³⁰ *Id.*

³¹ *Id.*

³² Helbitz et al., *supra* note 14, at 11.

B. Structure and Operation

Social impact bonds are sometimes called “pay for success” (“PFS”) bonds because they only pay upon realization of a contingency—successful completion of the social intervention program.³³ Successful completion means that predetermined program targets are met. The term “pay for success” highlights a key benefit of the SIB structure: if and when taxpayers have to repay bondholders, at least they have the comfort of knowing that they paid for a successful program.

“Pay for success” and “social impact bond” are not always synonyms, however. The government could, for example, execute a performance-based contract with a service provider directly. In typical government-funded social programs, risk of economic loss from unsuccessful programs lies with government; in a pure PFS arrangement, that risk is shifted to the service-providing nonprofit organization (“NPO”). The benefit of the SIB in conjunction with a PFS contract is that risk of loss is transferred to the private sector and away from financially fragile NPOs.³⁴

“Bond” is also an imperfect descriptor.³⁵ Unlike a traditional bond, the bondholder is not a creditor of the issuer unless the contingency is realized; a SIB purchaser never becomes a creditor if the program fails to achieve its target.³⁶ As a consequence of this, the SIB cannot pay out incrementally like a traditional bond. Performance targets used to evaluate the efficacy of social impact programs require time to assess. For instance, it would take many years to assess the true impact of a vocational skills program targeting long-term unemployed veterans. Thus, bondholders funding such a program would have to wait years to know whether they are entitled to any return.

While some variations will be discussed, especially in the early-goings, forthcoming SIB structures will likely be modeled on

³³ See, e.g., *Paying for Success*, *supra* note 3.

³⁴ David Howard & Lee Alman, *Response of the Doe Fund to Request for Information: Pay for Success Contracts and Social Impact Bonds*, THE DOE FUND, 4 (2011) (available with the Doe Fund upon request).

³⁵ Gilbert, *supra* note 8 (joking that SIBs should be renamed Social Impact Derivatives due to their “all or nothing risk profile”).

³⁶ Liebman, *supra* note 3, at 11.

the Peterborough project.³⁷ Appendix A contains a diagram depicting this expected structure of SIBs generally. The process is broken into various stages in which the six relevant players—government, lead contractor, private investors, service providers, target population and independent evaluator—interact with each other.

The process begins with a contract for services between the government and lead contractor/intermediary.³⁸ The contract will be a multi-year, performance-based contract, where the government promises to pay for services plus a premium if performance targets are achieved at the end of the service period.³⁹ If targets are not met, then government has no financial obligation under the contract.⁴⁰ Key terms include the precise population to be served, the service delivery period, the program performance targets and the government's contingent obligations once performance becomes measureable.⁴¹

Negotiation of these key terms will depend on many factors. The population served must be clearly delineated in the contract so as to maximize taxpayer savings, prevent confusion among service providers and provide clarity and predictability for investors.⁴² The service delivery period will depend on the population served, the nature of the services offered and the time required to achieve reliable results, balanced against the investor's demand for a reasonable timeframe. Performance targets must be based on achievable and realistic goals, balanced against the need to maximize taxpayer savings to fund investor returns that approach market rates.⁴³ Additionally, the metrics used for performance review after the service delivery period must be clearly delineated at the time of sale.⁴⁴ Finally, government obligations to bondholders will depend on the tax dollar savings realized from the program and the value to government of shifting the financial risk of program failure to the

³⁷ George Overholser, *Pay for Success/Social Impact Bonds: RFI Response from Third Sector Capital Partners*, THIRD SECTOR CAPITAL PARTNERS, 4 (June 10, 2011), available at http://www.thirdsectorcap.org/articles/RFI_response.pdf.

³⁸ Liebman, *supra* note 3, at 11.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.* at 15.

⁴² *Id.* at 22–23.

⁴³ Howard & Alman, *supra* note 34, at 4.

⁴⁴ *Id.*

private sector.⁴⁵ These are important variables, some of which are discussed in detail in Part III.

Next, the intermediary must secure funding for the service providers' operational needs so that the interventions can be delivered to the target population.⁴⁶ The intermediary raises funds by selling the government's contingent obligations to investors for cash.⁴⁷ As a practical matter, during pilot programs these investors are likely to be in place already. Philanthropists and foundations are likely to provide the bulk of SIB funding in the early issuances.⁴⁸ This investment pool will hopefully grow over time if pilot programs succeed, rates of return increase and certain tax kinks are worked out.⁴⁹

With funding in place, the lead contractor/intermediary works with government and service providers to come up with a flexible model for service delivery designed to achieve program objectives.⁵⁰ The intermediary selects and manages the service providers throughout the service delivery period to ensure that the program remains outcome-driven.⁵¹ At the end of the contract period, an independent evaluator analyzes the program's effect on the target population according to the predetermined outcome metrics.⁵² If the program successfully meets or exceeds these established targets, then government saves money and investors realize a return.⁵³

In the Peterborough pilot, the lead contractor also played the role of program financier, acting "like an investment bank to put the deal together."⁵⁴ Social Finance and its younger cousin, Third Sector Capital Partners, both envision this sort of role for themselves, especially during pilot stages.⁵⁵ As programs develop, however, it may be feasible for a well-coordinated service provider to assume the

⁴⁵ Liebman, *supra* note 3, at 12.

⁴⁶ *Id.* at 11.

⁴⁷ *Id.*

⁴⁸ Gilbert, *supra* note 8.

⁴⁹ *See id.*

⁵⁰ Overholser, *supra* note 37, at 4.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ Overholser, *supra* note 37, at 5.

⁵⁵ *Id.* at 1. Third Sector Capital Partners is "a nonprofit boutique investment bank [whose] purpose is [to] help capital flow into the social sector in healthy ways, and our focus is the fledgling Pay For Success/Social Impact Bond industry." *Id.*

role of lead coordinator and use an investment bank only for “the up-front structuring of the contract and the raising of SIB capital.”⁵⁶ For example, a financial intermediary was unnecessary for the New South Wales Government SIB pilot because of the Australian legal landscape.⁵⁷ In addition, independent professional management companies might be used to “orchestrate delivery, monitor day-to-day operational performance, gather and report upon performance data, and otherwise ensure that adequate focus is kept on achieving project success.”⁵⁸

The variation proposed for the New South Wales pilot is a risk-sharing model that does not burden the private investor with the full risk of program failure.⁵⁹ The Center for Social Impact explains, “[u]nder this option part of the costs the NPO incurs delivering the program will be paid by government through a standing charge, and the remaining costs and reward payment will be dependent on the achievement of a successful outcome.”⁶⁰ This alternative model requires the government to front some portion of operational costs while investors fund the remainder. One downside of such a hybrid model is that the government retains some risk of failure, which effectively limits the upside for private investors.⁶¹ The hybrid model may, however, attract a wider swath of investors “who are prepared to accept non-traditional terms and . . . investment[s],” but unwilling to risk 100 percent losses.⁶²

C. Benefits

The potential benefits of the SIB model are numerous, but fall into two overlapping categories. The first category concerns how the SIB construct can lead to substantively better program results by insisting on an efficient service model. The second relates to how the

⁵⁶ *Id.* at 5.

⁵⁷ THE CTR. FOR SOC. IMPACT, REPORT ON THE NSW GOVERNMENT SOCIAL IMPACT BOND PILOT 5 (Feb. 2011), available at http://www.csi.edu.au/assets/document/NSWSIB_ExecutiveSummary.pdf.

⁵⁸ Overholser, *supra* note 37, at 5.

⁵⁹ See REPORT ON THE NSW GOVERNMENT SOCIAL IMPACT BOND PILOT, *supra* note 57, at 6.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

SIB model incentivizes smarter NPO financing and government spending. These benefits are discussed below.

1. Service Delivery Efficiencies

Perhaps the most widely touted benefit of SIBs is their potential to revolutionize publically funded service delivery in the nonprofit sector. While prevention is usually cheaper than remediation, “[t]he public sector currently spends significant sums treating the symptoms of social problems, but considerably less tackling their causes.”⁶³ Prevention programs are complicated and costly.⁶⁴ Moreover, government authorities often have little political or financial incentive to invest in prevention.⁶⁵ SIBs flip these incentives by tapping into the economic potential of prevention programs. The SIB structure redirects money from safety-net programs to more effective early-intervention programs.⁶⁶

Additionally, traditional service delivery models focus on quantifiable services rather than quantifiable results.⁶⁷ Contracting for inputs and outputs is simpler than outcomes because the contractor simply counts the number of services delivered to measure performance with the contract. This approach is counterproductive, however, because “[p]ublic sector commissioners are encouraged to focus on defining the methods of service delivery rather than the impact of those services on clients’ lives.”⁶⁸ Similarly, an input and output focus drives service providers “to find more cost-effective ways of achieving the agreed outputs without enough thought for the desired outcomes.”⁶⁹ To be fair, outcome-based social evaluation metrics are notoriously difficult to develop and probably only became feasible with recent advances in administrative data management.⁷⁰

⁶³ Bolton & Savell, *supra* note 12, at 11.

⁶⁴ *See id.* at 12–13.

⁶⁵ *Id.*

⁶⁶ *See A New Tool For Scaling Impact: How Social Impact Bonds Can Mobilize Private Capital to Advance Social Good*, SOC. FIN., 2 (2012), available at <http://www.socialfinanceus.org/sites/socialfinanceus.org/files/small.SocialFinanceWPSingleFINAL.pdf> [hereinafter *A New Tool for Scaling Impact*].

⁶⁷ Bolton & Savell, *supra* note 12, at 13.

⁶⁸ *Id.* at 14.

⁶⁹ *Id.*

⁷⁰ *See Overholser, supra* note 37, at 3.

Contracting for outcomes with an intermediary rather than outputs with discrete service providers unlocks new service delivery potentials. One of the key roles of the intermediary will be to manage the various service providers to ensure that outcome targets are met.⁷¹ By contracting for outcomes, the intermediary is able to adapt program specifics on the fly, by scaling helpful services and eliminating or redirecting less helpful ones.⁷² In standard output contracting, the output is delivered irrespective of its value; often, the output to be delivered was chosen long ago and under outdated circumstances and assumptions.⁷³ Outcome contracting, on the other hand, forces contractors to respond to the immediately relevant needs of the target population in order to achieve success.⁷⁴

Outcome contracting through an intermediary allows “organizations . . . to join forces with other organizations to provide a tailored service that answer[s] the needs of their clients most effectively.”⁷⁵ Moreover, outcome contracting provides incentives for organizations to work with those individuals who are most costly to society. Output contracting, on the other hand, provides improper incentives for service providers to work with the least problematic populations, to which the required output is easier and cheaper to deliver. Finally, the very presence of sophisticated investors in the SIB structure has potential to further focus service delivery.⁷⁶

2. Rethinking NPO Financing

Many modern charities face serious funding problems. There is currently a great need for their services, however, as federal and local governments take austerity measures that “hurt families and reduce necessary services” in the midst of an economic recession.⁷⁷

⁷¹ See Goldberg, *supra* note 9.

⁷² The Peterborough project provides a useful example. At first, clients could request to be met at the gates by a service worker when released; over time, however, the moment of release was identified as a critically important moment; now the program involves “a proactive ‘Meet at the Gates’ service for every client, regardless of whether it was requested.” Helbitz et al., *supra* note 14, at 17.

⁷³ Bolton & Savell, *supra* note 12, at 13–14.

⁷⁴ Overholser, *supra* note 37, at 2.

⁷⁵ *Id.* at 4.

⁷⁶ Gilbert, *supra* note 8; Overholser, *supra* note 37, at 3.

⁷⁷ Nicholas Johnson, Phil Oliff & Erica Williams, *An Update on State Budget Cuts: At Least 46 States Have Imposed Cuts That Hurt Vulnerable*

All the while, dismal economic conditions force greater numbers to seek help from the very types of charitable and government services that are underfunded.⁷⁸

In addition to underfunding, charities often lack the financial or managerial expertise to effectively manage existing capital.⁷⁹ Similarly, these organizations are often unaware of alternative funding mechanisms and unreliable “in identifying [their] own financial needs”⁸⁰ Grants and donations have been the preferred funding choice of most charitable institutions, but the growing perception is that charities must learn to secure and utilize alternate funding in order to successfully and consistently implement their missions.⁸¹ Admittedly, SIB structures are not a panacea for every social problem, but—where viable—they present many advantages over traditional grant and appropriation financing.

Tapping new capital streams is critical for NPOs as they try to sustain social programs.⁸² Stable funding is important for service providers because it allows them to focus on what they do best—delivering social services to those in need. Multi-year contracts allow service providers to do more service providing and less time-consuming fundraising.⁸³ Moreover, the SIB structure infuses more transparency and honesty into social service funding.⁸⁴ From the perspective of the service provider, dependable funding is needed to awaken new opportunities for social change.

From the perspective of government, the biggest advantage of SIB funding is in outsourcing the risk of program failure to the more solvent private sector. Cash-strapped governments are

Residents and Cause Job Loss, CTR. ON BUDGET & POL’Y PRIORITIES, 1 (Feb. 9, 2011), available at <http://www.cbpp.org/files/3-13-08sfp.pdf>. A relevant example occurred when the District of Columbia “cut its homeless services funding by more than \$12 million, or 20 percent. It also reduced its cash assistance payments to needy families and cut funding for services that help low-income residents stay in their own homes and communities.” *Id.* at 14.

⁷⁸ See Liz Curtis, *Regional Networks to End Homelessness: Pilot Project*, MASS. INTERAGENCY COUNCIL ON HOUSING & HOMELESSNESS, 5 (Feb. 15, 2011), http://www.ppfound.org/documents/ichh_final_report.pdf.

⁷⁹ Goodall & Kingston, *supra* note 6, at 3.

⁸⁰ *Id.* at 4.

⁸¹ See *id.* at 5–6.

⁸² *A New Tool For Scaling Impact*, *supra* note 66, at 6.

⁸³ *Id.*

⁸⁴ See Helbitz et al., *supra* note 14, at 4.

unwilling to spend limited resources on untested approaches, especially when safety-net services are already overburdened.⁸⁵ SIBs provide for the risk of private investor funds rather than taxpayer dollars. Of course, the price of selling the risk is that a premium must be paid to investors if the program is successful. But where taxpayers save on the deal too, the price is right.

II. Homelessness in the Commonwealth and the Massachusetts Pilot Program

A. Homelessness in the Commonwealth

The first step to unlocking the potential of a SIB is to identify a target population that disproportionately consumes government resources but could be stabilized through adequate intervention programs. The Peterborough program targeted short-sentenced convicts. Other obvious candidates for SIB funding are homelessness prevention programs.

Annually in the Commonwealth, homelessness affects 5,000 families, including 10,000 children.⁸⁶ Massachusetts spends more and more on the problem each year, yet these numbers continue to rise.⁸⁷ A subset of the homeless population, the chronically homeless, costs taxpayers the most.⁸⁸ Yet, in Massachusetts, stable funding streams to address the needs of the chronically homeless do not exist.⁸⁹

By definition, chronically homeless individuals suffer from “complex medical, mental and addiction disabilities that are virtually impossible to manage in the unstable setting of homelessness.”⁹⁰ Symptoms are costly to address; the Massachusetts Housing and

⁸⁵ *A New Tool For Scaling Impact*, *supra* note 66, at 7.

⁸⁶ Dennis P. Culhane & Thomas Byrne, *Ending Family Homelessness in Massachusetts: A New Approach for the Emergency Assistance (EA) Program*, THE PAUL & PHYLLIS FIREMAN CHARITABLE FOUND., 2 (2010), available at <http://www.ppfound.org/documents/whitepaper.pdf>.

⁸⁷ Palandjian & Goldberg, *supra* note 4, at 43.

⁸⁸ *Id.* at 14.

⁸⁹ Curtis, *supra* note 78, at 65.

⁹⁰ MASS. HOUSING & SHELTER ALLIANCE, HOME & HEALTHY FOR GOOD: PROGRESS REPORT JUNE 2011, 2 (June 2011), available at http://www.mhsa.net/matriarch/documents/HHG_June2011_Report.pdf.

Shelter Alliance published a progress report on their *Home & Healthy for Good* program in June, 2011, explaining:

With an extreme level of disability, these individuals are among the highest utilizers of the state's health care systems. Clinicians from Boston Health Care for the Homeless Program (BHCHP) have collected data on the medical needs and costs associated with chronically homeless individuals living unsheltered on the streets. Over a five-year period, a cohort of 119 street dwellers accounted for an astounding 18,384 emergency room visits and 871 medical hospitalizations. The average annual health care cost for individuals living on the street was \$28,436, compared to \$6,056 for individuals in the cohort who obtained housing. A growing body of evidence in mental and public health literature shows dramatic improvement in health outcomes, residential stability and cost to society when homeless people receive supportive medical and case management services while living in permanent, affordable housing units.⁹¹

The *Home & Healthy for Good* program has enjoyed significant success: as of November 15, 2011, 543 chronically homeless individuals have been housed.⁹² The program's retention rate is an impressive 82 percent.⁹³ Appendix B shows the average usage of public services among program participants both pre- and post-housing. Annual costs per person for Medicaid, shelter and incarceration dropped from \$33,648 pre-housing to \$8,570 post-housing.⁹⁴ After adding the per person program costs of \$15,468, this computes to an annual savings of \$9,610 per housed tenant.⁹⁵ Thus,

⁹¹ *Id.*

⁹² MASS. HOUSING & SHELTER ALLIANCE, HOME & HEALTHY FOR GOOD: PROGRESS REPORT DECEMBER 2011, 9 (Dec. 2011), *available at* <http://www.mhsa.net/matriarch/documents/HHG%20Report%20December%202011%20Final.pdf>.

⁹³ *Id.*

⁹⁴ *Id.* at 13.

⁹⁵ *Id.*

Homelessness is one of the rare cases in which . . . Massachusetts [has] realistic and comprehensive plans for permanently ending the problem; [t]here are effective, evidence-based interventions for housing individuals . . . ; [t]here are capable nonprofit service providers that have well-established track records of successfully serving those populations; and [t]he potential for savings from offering homelessness prevention and permanent supportive housing services appear[s] large enough to pay for both the services and returns to investors.⁹⁶

B. The Massachusetts Pilot Program

Following the President's endorsement of the new concept, Massachusetts Governor Deval Patrick set the Commonwealth on course to be the first state in the union to implement SIB-funded PFS programs.⁹⁷ Social Finance even launched a sister office in Boston to help.⁹⁸ On May 6, 2011, the Commonwealth, through its Executive Office of Administration and Finance ("EOAF"), issued a Request for Information ("RFI") to solicit information from the public regarding where SIB programs would be most effective.⁹⁹ Over thirty interested service providers, intermediaries and potential investors submitted responses.¹⁰⁰

Given the enthusiastic response to the May 2011 RFI, the EOAF published a Request for Response ("RFR") on January 18, 2012 addressed to intermediaries and service providers interested in

⁹⁶ Palandjian & Goldberg, *supra* note 4, at 41.

⁹⁷ See Press Release, Mass. Exec. Office for Admin. & Fin., Massachusetts Pursues Social Innovation Financing to Spur Innovation and Build on Program Success (May 6, 2011), available at <http://www.mass.gov/anf/press-releases/mass-pursues-social-innovation-financing.html>.

⁹⁸ *History*, SOC. FIN., <http://socialfinanceus.org/work/history> (last visited Apr. 3, 2012).

⁹⁹ Request for Information, Mass. Exec. Office for Admin. & Fin., Pay for Success Contracts and Social Impact Bonds (May 6, 2011), http://ppp.cof.org/news/june-10th-deadline-to-respond-to-massachusetts-social-impact-bond-request-for-information_3054/ (follow "Request for Information (RFI)" hyperlink).

¹⁰⁰ These responses are public records available with the EOAF upon request.

working with the Commonwealth to address chronic homelessness.¹⁰¹ Through the RFR, the EOAF “seeks to partner with entrepreneurs from the provider community to execute a limited number of pay for success contracts targeted at providing stable housing for the chronically homeless.”¹⁰² The program is “designed to provide stable housing and other services for several hundred chronically homeless individuals with the goal of improving their well being and reducing Medicaid costs.”¹⁰³

In deciding to move forward with SIB funding, the Commonwealth noted the following funding difficulties commonly confronted by social service programs:

One year budget cycles make it difficult to manage long-term, preventative measures, particularly in social services; [t]ight budgets make state governments wary of putting taxpayer dollars at risk for new initiatives; [c]urrent funding is insufficiently focused on results and performance measurement, which allows less effective programs to persist, and reduces the state’s capacity for innovation; and [p]reventative programs often do not get funded out of the budgets they help reduce.¹⁰⁴

The Commonwealth also made the following findings regarding the benefits of PFS contracting, which include:

Creating incentives for improved program performance and reduced costs; [a]llowing for more rapid learning about which programs work and which do not; and [a]ccelerating the adoption of new, more efficient solutions.¹⁰⁵

¹⁰¹ See The RFRs, *supra* note 5.

¹⁰² *Request for Response (RFR): Social Innovation Financing for Homelessness—Service Providers*, COMMONWEALTH OF MASS., EXEC. OFFICE OF ADMIN. & FIN., 2 (Jan. 18, 2012), available at <https://www.ebidsourcing.com/displayPublicSolUniversalSummRFRUpdateDetails.do?doValidateToken=false&solUpdatesId=139795> (follow “Download Files Selected on this Page” hyperlink)

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 2–3.

¹⁰⁵ *Id.* at 3.

Based on these findings, the Commonwealth chose to move forward with a SIB-funded PFS program designed to address chronic homelessness.¹⁰⁶ “Chronically homeless” defines the target population and means an “unaccompanied homeless individual with a disabling condition who has either been continuously homeless for a year or more, or has had at least four episodes of homelessness in the past three years.”¹⁰⁷ The Commonwealth’s definition mostly tracks the definition of “chronically homeless” from The Homeless Emergency Assistance and Rapid Transition to Housing Act of 2009 (“HEARTH Act”).¹⁰⁸ Massachusetts expands the HEARTH Act’s definition for the purposes of the RFR, adding that “a person shall also be considered chronically homeless if the person has been identified by a shelter provider as a frequent user of shelter and medical and emergency services.”¹⁰⁹

To address the needs of this population, the EOAF seeks to develop a program that achieves the following goals:

Establish permanent housing for the chronically homeless; [p]rovide appropriate support for those individuals who are housed; and [p]romote positive health outcomes with those housed such that acute medical care usage is significantly decreased.¹¹⁰

While details are still unformulated, it is anticipated that:

- (1) The project will attempt to house 400 homeless individuals over a three-year service delivery period: five total years including planning and start-up at the beginning and service maintenance and measurement at the end;¹¹¹

¹⁰⁶ *Id.* at 4. The Commonwealth will also be piloting a recidivism prevention program for youth offenders as they age out of Department of Youth Services jurisdiction. *See Request for Response: Pay for Success Contracting for Youth—Service Providers*, *supra* note 18.

¹⁰⁷ The RFRs, *supra* note 5, at 4.

¹⁰⁸ The Homeless Emergency Assistance and Rapid Transition to Housing Act of 2009, 42 U.S.C. 11302 § 103 (2009).

¹⁰⁹ The RFRs, *supra* note 5, at 4.

¹¹⁰ *Id.*

¹¹¹ *See Answers to Submitted RFR Questions*, COMMONWEALTH OF MASS., EXEC. OFFICE OF ADMIN. & FIN., 2 (Feb. 27, 2012), available at <https://www.ebidsourcing.com/viewDoc?doValidateToken=false&docPath=>

- (2) The annual cost savings to the state per successfully-housed individual from reductions in other spending will be roughly \$20,000;¹¹²
- (3) Costs associated with providing housing subsidies for housed individuals will need to persist indefinitely;¹¹³ and
- (4) The Commonwealth seeks to have the budgetary cost of the initiative be no greater than the savings produced.¹¹⁴

By law (801 CMR 21.00), agencies of the Commonwealth are required to contract for services through “a competitive procurement process,” hence the RFR.¹¹⁵ The RFR went through a question-and-answer period before the response period closed on March 9, 2012.¹¹⁶ Massachusetts is currently in the process of sorting through the responses with the goal of finalizing contracts by the end of the year.¹¹⁷

III. Challenges to Successful Implementation of SIB Programs

There will be many challenges involved in implementing a successful SIB-funded intervention program. Among these challenges are: defining the target population, planning a rigorous evaluation, passing necessary legislation and resolving tax issues.

%2FPublic%2FSolicitations%2F127963%2F00004%2FRFR%2FRFRQuestions2_21_Final.pdf [hereinafter RFR Questions].

¹¹² *Id.*

¹¹³ *Id.* at 4.

¹¹⁴ The RFRs, *supra* note 5, at 10.

¹¹⁵ *Id.* at 5.

¹¹⁶ CommPass: Procurement Access & Solicitation System, COMMONWEALTH OF MASS., https://www.ebidsourcing.com/displayPublicSolInqClosedSolEntityList.do?browseType=BYDEPT&doValidateToken=false&entityTitle=Executive+Office+of+Administration+and+Finance&deptDesc=Executive+Office+of+Administration+and+Finance&menu_id=2.3.2.2.1.1&deptId=2060 (1st visited Apr. 5, 2012) (showing that the social innovation financing RFRs closed on March 9, 2012).

¹¹⁷ RFR Questions, *supra* note 111, at 8.

A. Defining the Target Population

Clearly defining the target population to be served and evaluated is pivotal if the program is to fulfill its mission of saving taxpayer money. This task is inherently more difficult in homelessness prevention than in recidivism prevention programs precisely because the chronically homeless are difficult to locate. All of the participants in the Peterborough pilot were gathered from the same prison.¹¹⁸ Nonetheless, for outcome evaluations to be meaningful, all parties must be perfectly clear as to the target population at all stages of the program.

The target population should probably be defined by an entity other than a service provider.¹¹⁹ Service provider selection would run the risk of “cream-skimming,” which occurs when the provider offers services only to those who are most likely to benefit from intervention.¹²⁰ Cream-skimming is counterproductive to the SIB model because it excludes the individuals who are costing taxpayers the most money.

Massachusetts should remain vigilant of the potential for cream-skimming in its proposed SIB program. The Commonwealth’s expanded definition of “chronically homeless” includes those who have been designated by shelter providers as frequent users of shelters and medical emergency services; it appears to give providers a mechanism for choosing participants without a “disabling condition.”¹²¹ This sloppy language could become problematic if providers choose the 400 homeless individuals to be served during the delivery period based on proven conformity with the Commonwealth’s definition of “chronically homeless.” The Massachusetts pilot program could avoid the danger by instead choosing the 400 individuals during contract negotiations. This safeguard appears to be in the current plan:

The state anticipates working with its contract partners to identify an appropriate population to serve. Most likely, the 400 individuals will be identified from a combination of sources including existing registries of homeless individuals

¹¹⁸ Bolton & Palumbo, *supra* note 15, at 1.

¹¹⁹ Liebman, *supra* note 3, at 22.

¹²⁰ *Id.*

¹²¹ See The RFRs, *supra* note 5, at 4.

maintained both by governments and service providers and through the use of Medicaid program data. If it is possible to identify more such individuals than can be served with available funds, a lottery will be used both in the interest of fairness and of establishing a reliable counterfactual.¹²²

B. Rigorous Evaluation

Third Sector Capital has identified rigorous evaluation as the most important component to early SIB program success.¹²³ In the absence of rigorous evaluation, failure could go unnoticed while every party to the transaction claims success.¹²⁴ False positive evaluations in the context of impact measuring can be caused by factors such as “underpowered experimental designs, publication bias, low-fidelity execution, wishful thinking, regression to the mean, and many others.”¹²⁵ The danger of false positive evaluation is lessened significantly, however, if throughout the project there is “the continued presence of highly rigorous independent expert evaluators, with a strong focus on counterfactuals, and a power to audit”¹²⁶ For this reason, those with a stake in the outcome must be excluded from the evaluation process once outcome metrics are determined.

Tied to the concept of rigorous evaluation is the importance that early program design withstands scrutiny from a skeptical public. Successful or not, programs must be evaluated to an extent that gives the program model validity in the eyes of institutional investors. Early evaluations must be both simple and rigorous if SIBs are ever to move beyond foundation money.¹²⁷

¹²² RFR Questions, *supra* note 111, at 3. *See also* Liebman, *supra* note 3, at 22 (“[I]f there is excess demand . . . , a lottery could determine which [individuals] receive services and which ones do not. Then, comparing outcomes between lottery winners and lottery losers gives a credible assessment of the program’s impact.”).

¹²³ Overholser, *supra* note 37, at 7.

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ Howard & Alman, *supra* note 34, at 4.

C. Required Legislation

Typical appropriations statutes are often unable to commit the government to either multi-year or contingent contracts, while a PFS/SIB contract requires both.¹²⁸ Governments do not typically enter into six-year contracts, in part because their nature and political leanings are subject to change with every election.¹²⁹ Additionally, the government is not used to appropriating monies that it might not have to pay down the road.¹³⁰ As to this second problem, Liebman's proposed solution is that "Congress should . . . pass an appropriations statute that authorizes long-term contracts and allows for future redirection of any unused funds, for another closely related high-priority purpose."¹³¹ Alternatively, because "unused" funds were originally appropriated under the assumption of program success, program failure could result in the return of these funds to the safety net programs from which they were taken.

The problem of multi-year contracting is solved by pledging the government's full faith and credit to multi-year commitments. Thus, SIB pilot initiatives need the help of legislators. Governor Patrick recently proposed legislation in Massachusetts which would allow the EOAF Secretary access to \$50,000,000 for SIB contracting backed by the full faith and credit of the Commonwealth.¹³²

¹²⁸ Liebman, *supra* note 3, at 5.

¹²⁹ Gilbert, *supra* note 8.

¹³⁰ Liebman, *supra* note 3, at 6.

¹³¹ *Id.*

¹³² An Act Making Appropriations for the Fiscal Year 2012 to Provide for Supplementing Certain Existing Appropriations and for Certain Other Activities and Projects, Legislation No. 3898 § 35XX (proposed Jan. 25, 2012), available at <http://www.mass.gov/legis/journal/desktop/Current%20Agenda%202011/H3898.pdf> (reprinted in part below).

Section 35XX. (a) There shall be established and set up upon the books of the commonwealth a trust to be known as the Social Innovation Financing Trust Fund, in this section called the trust, for the purpose of funding contracts to improve outcomes and lower costs for contracted government services, in this section called pay for success contracts, subject to the requirements of subsection (b).

A related appropriations challenge will be the extent to which government is able to reallocate existing resources during the SIB program period. The initial SIB premise is that “preventative activity could be funded from savings made in acute spending as a result of successful preventative work.”¹³³ This critical component of the SIB structure remains untested in the Peterborough pilot because, there, the Big Lottery is responsible for investor payouts.¹³⁴ Additional infusions of capital are always welcomed by cash-strapped NPOs, but the SIB model is really about smarter use of existing funds—ultimately, reallocation of government resources

(b) Notwithstanding any general or special law to the contrary, the secretary of administration and finance, in this section called the secretary, may enter into pay for success contracts. Each contract shall include: (1) a requirement that a substantial portion of the payment be conditioned on the achievement of specific outcomes based on defined performance targets; (2) an objective process by which an independent evaluator will determine whether the performance targets have been achieved; (3) a calculation of the amount and timing of payments that would be earned by the service provider during each year of the agreement if performance targets are achieved as determined by the independent evaluator; (4) a sinking fund requirement under which the secretary shall request an appropriation for each fiscal year that the contract is in effect, in an amount equal to the expected payments that the commonwealth would ultimately be obligated to pay in the future based upon service provided during that fiscal year, if performance targets were achieved; and (5) a determination by the secretary that the contract will result in significant performance improvements and budgetary savings across all impacted agencies if the performance targets are achieved.

(c) The secretary, in his discretion, may provide that payments in future years under such contracts shall constitute a general obligation of the commonwealth for which the full faith and credit of the commonwealth shall be pledged for the benefit of the provider or providers of the contracted government services, but the total amount of payments . . . shall not in the aggregate exceed \$50,000,000.

¹³³ See Gilbert, *supra* note 8.

¹³⁴ See Helbitz et al., *supra* note 14, at 11.

resulting from successful SIB programs has the potential to generate far more revenue for additional social projects than the mere infusion of a little extra private capital.¹³⁵

Consider the homelessness pilot being developed in Massachusetts. If the program is effective, the Commonwealth realizes savings across many different agencies. Program success would mean reductions in medical spending, shelter use, incarceration and other social services funded by the state. Ideally, the government would reduce the budgets of the affected agencies proportionately with the savings generated by the SIB program. If a successful program does not result in a corresponding decrease to other services, then government has not saved any money—it has only spent more to serve more people.

An ambitious future goal for SIB programs, if proven viable, is to move towards greater cost sharing for SIB programs between local, state and federal governments. In the fledgling Massachusetts homelessness pilot, for example, “savings estimates [of \$20,000/per successfully housed individual] . . . include only state Medicaid cost savings and not federal Medicaid cost savings” that might also be realized.¹³⁶ Of course, the Massachusetts legislature does not have access or authority to re-appropriate federal Medicaid funds for state purposes. However, there is no reason that a state program that saves federal dollars should not be partially financed out of the federal savings. The legislation would undoubtedly prove complicated, but having access to all of the savings generated from a particular SIB program allows for contract terms that are more investor friendly. This is important where the ultimate goal is to lure institutional investors into the mix.

D. Tax

Finally, it will be interesting to see what kind of tax solutions the Commonwealth and the federal government put in place to address the multi-year and charitable components of the SIB funding model. Because the government already realizes significant savings upon successful completion of a SIB-funded program, legislators should consider exempting investor SIB

¹³⁵ Overholser, *supra* note 37, at 3.

¹³⁶ RFR Questions, *supra* note 111, at 2.

earnings from capital gains taxation. SIB investments are unlike traditional investments because they are designed specifically to save taxpayers money; we should not penalize these investors by taxing their gains. Additionally, exempting SIB earnings from the capital gains tax will help SIB investments approach the market rate, hopefully luring in more investors. However, the multi-year component of SIBs will present added difficulties in configuring a tax solution because a SIB's value is unknown until the end of the service delivery period.¹³⁷

Even more important are the tax consequences for investors in the event of an unsuccessful program. Perhaps the most unforgiving aspect of proposed SIB models is that investors lose everything if performance targets are missed. In order to alleviate some of this financial risk, “[i]deally, investors would receive a charitable tax deduction if they are not going to see a return on their investment.”¹³⁸ A charitable deduction tax fix is critical, both in the interests of fairness to these brave initial investors and to properly align incentives for a more robust future investment if early programs are successful.

Conclusion

As SIBs continue to garner more attention, new opportunities are arising. State and local governments should be advised that early pilots might create opportunities for federal funding of future programs. Obama's fiscal year 2012 budget designates up to \$100 million for PFS projects.¹³⁹ The Department of Labor has committed \$20 million to launch pilots that improve employment and training outcomes, and the Department of Justice will “give priority funding consideration in 2012 Second Chance Act grant solicitations to highly qualified applicants who incorporate a Pay for Success model in their program design.”¹⁴⁰ These monies will be made available this

¹³⁷ See Overholser, *supra* note 37, at 6.

¹³⁸ Howard & Alman, *supra* note 34, at 4.

¹³⁹ *Paying for Success*, *supra* note 3.

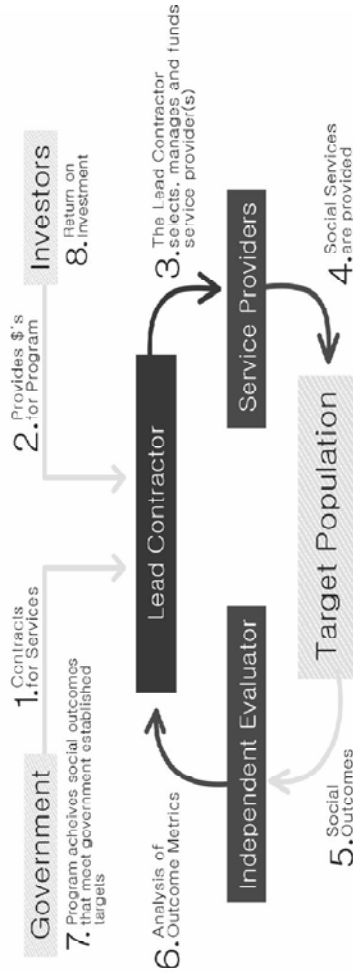
¹⁴⁰ Cecilia Muñoz & Robert Gordon, *Pay for Success: A New Results-Oriented Federal Commitment for Underserved Americans*, THE WHITE HOUSE BLOG (Jan. 24, 2012, 12:06 PM), <http://www.whitehouse.gov/blog/2012/01/24/pay-success-new-results-oriented-federal-commitment-underserved-americans>.

year through funding competitions, and Massachusetts and New York stand in good position to benefit.¹⁴¹

In sum, government, service providers and investors all have reason to be excited about SIBs. The model is theoretically convincing, but its successful implementation will require a great deal of work and patience. Regardless of whether the early SIB projects prove successful, the financial and operational evolution of social programs will become necessary to effectively and efficiently address important social problems.

¹⁴¹ *Id.*

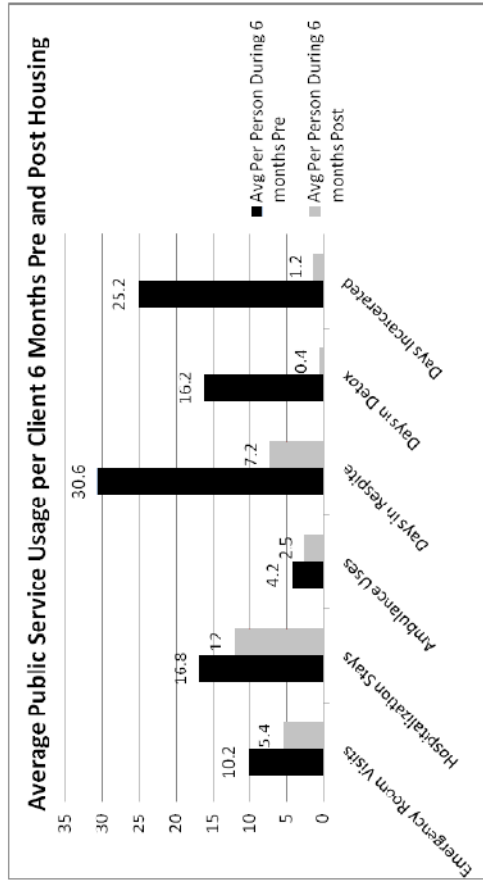
APPENDIX A¹⁴²



1: The government contracts the Lead Contractor for services. **2:** The investors provide the resources for the Program. **3:** The Lead Contractor selects, manages and funds service providers. **4:** The Service Providers offer social services to a target population. **5:** The Lead Contractor manages providers to ensure social outcomes are met. **6:** Independent Evaluators and Lead Contractor verify outcomes through rigorous processes. **7:** Program achieves social outcomes that meet government established targets. **8:** If social outcomes meet government set targets, investors receive a return on investment. Otherwise, government is not obligated to make any payments.

¹⁴² Overholser, *supra* note 37, at 4.

APPENDIX B¹⁴³



¹⁴³ HOME & HEALTHY FOR GOOD: PROGRESS REPORT DECEMBER 2011, *supra* note 92, at 10.