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

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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**.
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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

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

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”.

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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

**PAYOR**
- Government, Insurance Companies, Health Systems

**INTERMEDIARY**
- Foundation, Nonprofit, Social Finance US, Third Sector Capital Partners

**SUBORDINATE LENDER**
- Foundation, CDFI, Impact Investor

**SUBORDINATE SOCIAL IMPACT LOAN**

**COMMTS FUNDING**

Source: Federal Reserve Bank of San Francisco
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
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

1. Payor (Government, Insurance Companies, Health Systems) commits funding
2. Intermediary (Foundation, Nonprofit, Social Finance US, Third Sector Capital Partners) measures impact
3. Senior lender
4. Stream of payments to fund intervention
5. Service provider
6. Evaluates success

Source: Federal Reserve Bank of San Francisco
What Are Social Impact Bonds (SIB)?

Basic Transaction Structure

1. **PAYOR**
   - Government, Insurance Companies, Health Systems
   - Commits funding
   - Success payments
   - Validates success

2. **INTERMEDIARY**
   - Foundation, Nonprofit, Social Finance US, Third Sector Capital Partners
   - Measures impact

3. **SERVICE PROVIDER**
   - Stream of payments to fund intervention

4. **SUBORDINATE SOCIAL IMPACT LOAN**
   - Loan repayment

5. **EVALUATOR**
   - Measures impact

6. **SUBORDINATE LENDER**
   - Foundation, CDFI, Impact Investor
   - Senior social impact loan
   - Senior lender

7. **SENIOR LENDER**

**Source:** Federal Reserve Bank of San Francisco
What Are Social Impact Bonds (SIB)?

Basic Transaction Structure

1. Payor commits funding to the intermediary.
2. The intermediary repays the loan to the senior lender.
3. The senior lender receives a loan repayment.
4. The service provider measures impact.
5. The evaluator validates success.
6. Success payments are made to the intermediary.
7. The stream of payments funds the intervention.
8. The payor repays the subordinate lender.

Source: Federal Reserve Bank of San Francisco
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

[Diagram showing the transaction structure with the following entities:]
- J.B. Pritzker Foundation (Subordinate Lender)
- United Way of Salt Lake (Intermediary)
- Salt Lake County (Payor)
- State of Utah (Details TBD) (Payor)
- Goldman Sachs Bank USA and the Federal Reserve Bank of San Francisco (Funding)

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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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.

<table>
<thead>
<tr>
<th>Economic Well-Being</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Children in poverty</td>
<td>- Low-birth-weight babies</td>
</tr>
<tr>
<td>- Children with a high housing cost burden</td>
<td>- Child and teen deaths/100,000</td>
</tr>
<tr>
<td>- Children with parents lacking secure employment</td>
<td>- Children without health insurance</td>
</tr>
<tr>
<td>- Teens not in school and not working</td>
<td>- Teens who abuse alcohol or drugs</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Education</th>
<th>Family &amp; Community</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Children not attending preschool</td>
<td>- Children in single-parent families</td>
</tr>
<tr>
<td>- Eighth graders not proficient in math</td>
<td>- Children living in high-poverty areas</td>
</tr>
<tr>
<td>- Fourth graders not proficient in reading</td>
<td>- Children in families where the household</td>
</tr>
<tr>
<td>- High school students not graduating on time</td>
<td>head lacks a high school diploma</td>
</tr>
<tr>
<td></td>
<td>- Teen births per 1,000</td>
</tr>
</tbody>
</table>

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)

- Savings to government: $52.6
- Cost of NFP for 2,750 mothers: $21.3
- Cost of success auditor and intermediary: $2.7
- Net savings from SIB: $28.6
- Return (10%) to investors: $14.3
- Savings to tax payers: $14.3

Principal repaid to investors: $24

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)

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

*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.
2. Type your question into the chat box of the webinar.
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

• Information about future sessions will be posted on our website along with archived materials from past sessions: www.stlouisfed.org/connectingcommunities/
In connection with this session, you can find a variety of additional resources, available at [www.fedcommunities.org](http://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 14th: **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