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SOCIAL IMPACT BONDS: CAN THEY HELP GOVERNMENT ACHIEVE BETTER RESULTS FOR FAMILIES IN NEED?

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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SOCIAL IMPACT BONDS: CAN THEY HELP GOVERNMENT ACHIEVE BETTER RESULTS FOR FAMILIES IN NEED?

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON HUMAN RESOURCES,
Washington, DC.

The subcommittee met, pursuant to call, at 2:05 p.m., in Room 1100, Longworth House Office Building, the Honorable Dave Reichert [chairman of the subcommittee] presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON HUMAN RESOURCES

FOR IMMEDIATE RELEASE
July 23, 2014
No. HR-13

CONTACT: (202) 225-1025

Chairman Reichert Announces Hearing on Subsidized Job Programs and their Effectiveness in Helping Families Go to Work and Escape Poverty

Congressman Dave Reichert (R-WA), Chairman of the Subcommittee on Human Resources of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on subsidized jobs programs and their effectiveness in helping families escape poverty. **The hearing will take place at 2:00 pm on Wednesday, July 30, in room 1100 of the Longworth House Office Building.**

In view of the limited time available to hear from witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include individuals with experience administering subsidized employment programs and experts who have studied the effectiveness of these programs. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Helping people find full-time jobs is the best way to reduce poverty. Over 97 percent of individuals age 18-64 who work full-time have earnings that place them above the poverty line, while almost one-third of individuals in that age range who do not work are in poverty. Working full-time also helps individuals move up the economic ladder. Of households in the bottom 20 percent of the earnings distribution, fewer than one in five had a household member working full-time, and more than 60 percent included no one who was working. Households in the top 20 percent of earners had on average two household members working, in almost all cases full time.

The major accomplishment of the 1996 welfare reforms was to help more low-income families and individuals find jobs, so they could escape poverty and dependence on government benefits and move up the economic ladder. Since the work-based welfare reforms were enacted, the employment rate of adults receiving Temporary Assistance for Needy Families (TANF) welfare benefits has more than

doubled.[1] Child poverty rates fell dramatically in the years immediately after welfare reform, while welfare caseloads declined by 60 percent through June 2013. In addition to expecting more welfare recipients to work and prepare for work, welfare reform provided more flexibility for States to support work by providing child care benefits, transportation assistance, and other work supports.

While welfare reform moved many low-income families into work, more can be done to help welfare recipients work and escape poverty. States now report spending only a small share of their TANF funding – 6 percent in FY 2013 – on activities designed to get welfare recipients jobs. Although States are required to engage 50 percent of welfare recipients in work or work-related activities, 22 States face effectively no such requirement because of loopholes in the law. Further, in the most recent State data on work performed by welfare recipients (FY 2011), States reported that almost 60 percent of adults performed no hours of work or work-related activities, such as education or training.

A number of States have taken steps to more quickly move welfare recipients into the workforce, in some cases providing wage subsidies to employers to hire these individuals so they can earn a paycheck instead of receiving welfare. State approaches to subsidizing employment have been varied, including by the type of recipient placed in subsidized jobs, whether the placement is in the public or private sector, the length of the subsidy, and the amount of the subsidy. Specific Federal funding for this purpose was provided under the 2009 economic stimulus law (P.L. 111-5), under which $1.3 billion was spent on subsidized jobs programs between 2009 and 2010. Placing welfare recipients in subsidized jobs can help these individuals gain skills that will help them find and maintain full-time employment. However, because research on the long-term impacts of subsidized jobs is mixed, it is important to review the structure of different subsidized jobs programs to determine which features appear most likely to make these programs successful.

In announcing the hearing, Chairman Reichert stated, **"Our nation's welfare programs should be focused on one thing – helping people in need find work, so they can escape poverty and move up the economic ladder. The 1996 welfare reforms achieved this goal by requiring States to get welfare recipients working or preparing for work. One of the ways States have done so is by connecting recipients quickly with employers, sometimes by subsidizing their wages. Welfare reauthorization is on hold as the Administration continues to insist – despite 15 years of TANF law and precedent to the contrary – that it can waive the critical TANF work requirements. So now is a good time for us to review how these subsidized job programs are working. I look forward to hearing more about these State efforts so we can improve our nation's welfare system and move more people out of poverty."**

FOCUS OF THE HEARING:

This hearing will focus on State subsidized jobs programs designed to move individuals from welfare to work, including what research reveals about the impact of such programs on employment and earnings.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

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[1] U.S. Department of Health and Human Services. TANF Tenth Report to Congress. Figure 10-H, Trend in Employment Rate of TANF Adult Recipients, FY 1992 – FY 2011.

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://waysandmeans.house.gov, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Please click here to submit a statement or letter for the record." Once you have followed the online instructions, submit all requested information. Attach your submission as a Word document, in compliance with the formatting requirements listed below, **by August 13, 2014.** Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-1721 or (202) 225-3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available online at http://www.waysandmeans.house.gov/.

Chairman REICHERT. Thank you for being here today. We will call the committee to order.

Of course, today's hearing is on social impact bonds, and our goal today is to review these innovative financing ideas and determine whether they can help government achieve better results for families in need.

And to discuss this approach in greater detail as well as legislation that he has introduced to promote development of social impact bonds, I want to yield the balance of my time to the gentleman from Indiana, Mr. Young.

Mr. YOUNG. Well, I want to thank Chairman Reichert for holding this hearing today to discuss how social impact bonds can be an innovative tool to improve social and public health outcomes, save taxpayer resources, and unleash non-governmental investment capital to help at-risk Americans.

I also want to thank our panelists for being here today to share testimony with the committee.

I want to give special recognition to Congressman Delaney, a Maryland Democrat and a very conscientious colleague, for his leadership and partnership with me on this initiative. This is the sort of big-idea, bipartisan initiative that we need more of in Washington, and he has helped make that happen here.

Now, I studied a bit of economics at the University of Chicago, and I want to start today with a quote from Milton Friedman, who once said, "One of the great mistakes is to judge policies and programs by their intentions rather than their results."

I have spent the last 2 years on this subcommittee learning about many of our Nation's social services programs, and I found that to ring exceedingly true. For all our best intentions, each of us knows that too often we see government programs fail the constituencies they are intended to help and the taxpayers who fund them.

Unfortunately, instead of trying to determine how to get better results, serious discussions about social service provisions tend to devolve quickly into superficial arguments over funding levels. Instead of outcomes, we spend too much time talking about inputs. Now, to some, it is tempting to measure compassion with dollar signs, but this was not and is not what our social safety net is all about.

Social impact bonds can help change our focus from inputs to outcomes, where it belongs. They do this by requiring every approved project to answer three basic questions at the outset:

One, what does a successful outcome look like?

Two, whom are we trying to serve?

And, three, what is the value of a successful outcome in terms of current government spending?

When those questions are answered, we can develop programs with measurable policy goals and measurable savings. Measurable policy goals and savings are pre-conditions to using social impact bonds as a funding mechanism to raise private investment capital, administer the evidence-based social intervention. And then, if and only if those policy goals are met, the Federal Government can pay back those initial investors.

If the goals aren't met, the Federal Government doesn't owe a dime. In essence, SIBs bring pay-for-performance to the social and public health sectors, allowing the Federal Government to improve both the impact and cost-effectiveness of vital government services.

In short, the Social Impact Bond Act, which I sponsored with Congressman Delaney as well as Mr. Griffin and Mr. Reed on this subcommittee and several Democrats, including Mr. Larson, who is joining us here today, empower states, local governments, non-profits and the private sector to scale up evidence-based social and public health interventions to address some of our Nation's most pressing social challenges.

The results of these projects will help empower well-intentioned policymakers across all levels of government to improve lives through evidence-based policymaking as well as aid non-profits in expanding their models with fidelity across different geographies and populations.

In turn, this expands our menu of policy options and offers meaningful alternatives to simply increasing funding for existing government programs that we know are less than successful at meeting their stated policy objectives.

With that, I will once again thank our panelists for being here today, thank the chairman for this opportunity.

And I yield back.

Chairman REICHERT. I thank you, Mr. Young.

Mr. Doggett, would you like to give an opening statement?

STATEMENT OF THE HONORABLE LLOYD DOGGETT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. DOGGETT. Thank you very much, Mr. Chairman.

I welcome the discussion about how we invest in our future. In a time when there are so many valuable initiatives that are limited by budget squeezes and even by sequestration, it is important to be as creative as possible.

I salute Mr. Young, Mr. Larson and their co-sponsors for recognizing the need to invest more in programs that will help low- and middle-income Americans get an education, attain long-time employment, and be successful in other areas.

We know that social impact bonds are a relatively new phenomenon, having, I believe, begun in the United Kingdom in about 2010. I am familiar with the effort in New York City and Rikers Island, the work being done in Utah.

The question we have today is the impact of social impact bonds as a new phenomenon and whether this is the best way to encourage stronger and more responsive communities.

Since the States are laboratories of democracy, one question presented by today's hearing is whether Federal intervention is necessary or desirable at this early stage.

Most of us are familiar with the old saw that a conservative is someone who says, "You go first." Well, we have a method in the States and the localities already to determine how effective these programs are and to evaluate whether they are accomplishing their objectives. I look forward to hearing from each of our witnesses on this question.

I know that many of our programs, including those in which this committee has been involved in the past, face significant questions as to whether they can continue even next year.

Home visiting for at-risk mothers and their children is set to expire next March, and I do have some doubts as to whether now is the time to implement a funding structure that will help put taxpayer dollars with some third-party investors instead of directly into the future of these children.

I welcome the good counsel of all of those present, and I think we must be open to new ideas. We just need to be sure that those new ideas are the best way to make effective use of what are fairly precious taxpayer dollars.

And I thank you, Mr. Chairman.

Chairman REICHERT. Thank you, Mr. Doggett.

And I show there is some agreement on the panel here. I want to thank all of you for being here, and we do look forward to the information that you will provide us today.

We are looking for new and innovative ways where we can help people in this country, and I think we need to keep an open mind as to how we do that. And your information today will help us determine if we should do anything in the Federal Government or not.

So, again, appreciate your testimony you are about to give, and thank you for being here again today, as I said.

Without objection, each member will have the opportunity to submit a written statement and have it included in the record.

I want to remind our witnesses to limit their oral statements, please, to 5 minutes. However, without objection, all of the written testimony that you have submitted will be a part of the permanent record.

On our panel this afternoon, we will be hearing from Sam Schaeffer, CEO, Center for Employment Opportunities; Robert Romo, former client, Center for Employment Opportunities; Linda Gibbs, principal, Bloomberg Associates; David Juppe, senior budget operating manager, Maryland Department of Legislative Services; and George Overholser, CEO and co-founder, Third Sector Capital Partners.

Mr. Schaeffer, thanks for being here today, and proceed with your testimony, please.

STATEMENT OF SAM SCHAEFFER, CEO AND EXECUTIVE DIRECTOR, CENTER FOR EMPLOYMENT OPPORTUNITIES

Mr. SCHAEFFER. Thank you, Chairman Reichert, Ranking Member Doggett, and all the Members of the Committee for highlighting social impact bonds at today's hearing.

SIBs have the potential to scale some of this country's most effective social interventions, helping communities expand programs that have proven results and save taxpayer dollars.

My name is Sam Schaeffer, and I am the executive director and chief executive officer of the Center for Employment Opportunities, or CEO.

CEO is an organization devoted to exclusively meeting the employment needs of men and women with histories of incarceration. Since founded in New York City in 1996, CEO's transitional jobs

program has helped more than 16,000 people coming home from prison secure full-time employment.

CEO has been proven, through random assignment evaluation, to reduce recidivism and provide up to $3.30 in taxpayer savings for every dollar invested in the program. Over the last 5 years, CEO has leveraged its expertise to expand into ten cities across California, Oklahoma, and New York State.

In a few moments, you will hear from Robert Romo, one of the thousands of individuals we have worked with every year, on how CEO turned his life around. Robert's story illustrates the challenges so many face when coming home from prison.

Every year more than 60,000 people are released, but more than 40 percent will return. This failure is costly. The United States spends $64.3 billion annually on incarceration.

It also has a profound effect on public safety, as well as families and communities impacted by the criminal justice system. Attracting new capital for prisoner re-entry programs like CEO is critical.

In December 2013, CEO, New York State and the intermediary, Social Finance, began a 4-year SIB project that will help us serve an additional 2,000 high-risk recently released men in New York City and Rochester. 44 private investors provided $13.5 million in capital to support this expansion of services.

This is a performance-based contract, but instead of focusing on outputs like job placements, it hinges on our organization making an impact on recidivism and long-term employment.

If a random assignment evaluation shows that individuals in the treatment groups spend at least 8 percent fewer days in jail or prison than the control group and shows a 5 percent increase in their immediate and long-term employment, USDOL and the State of New York will return investors their upfront capital. If we exceed these measures, returns can reach as high as 12.5 percent. But if the targets are not met, investors stand to lose their capital.

CEO is excited to take part in this historic project. It represents a watershed moment in which both the State of New York and the Federal Government are supporting the full funding of our core model delivered to our primary service population.

What is more, the contract aligns our partners in New York and Social Finance to drive effective performance management, fidelity, and collaboration. Congressman Young and Delaney's Social Impact Bond Act provides robust tools to create more deals like CEO's SIB.

Drawing on our organization's experience, I would humbly offer the following suggestions to help guide this nascent field, several of which are also contained in Young-Delaney.

Select experienced, proven providers. At this early stage, it is important to select service providers whose programs have been proven through experimental or quasi-experimental studies. For the field to gain steam, we need to construct projects around interventions most likely to demonstrate impact.

Choose performance and repayment metrics carefully. Performance thresholds must be achievable based on a provider's track record. Projects should only aim to achieve results that are consistent with provider's historical performance.

Attract new capital. Don't cannibalize. One of CEO's interests in participating in the SIB was accessing new forms of financial support. If CEO's existing government or philanthropic funding were diverted to support this SIB, the project's appeal would have diminished considerably.

Government champions are critical. For a deal to close and be successfully operationalized, strong government leadership is essential. Government must be committed as a payor, but also as a performance and operations partner.

Help providers manage risk. Government should provide tools for providers negotiating transaction. The risk of any large, high-profile project is significant, and they will benefit from the help assessing evaluation design, investment terms, among other areas.

Finally, cost-benefit is key, but it is not the only thing. We should find a way to support projects with clear societal, if not exclusively monetary, benefits. Interventions focusing on violence reduction or literacy, for example, may show impacts, but fewer cost savings. These projects should receive support, if they produce results, government values.

Not all social problems can or should be solved by SIBs, but in a resource-scarce environment, SIBs allow government to support proven interventions that show impacts on a specific social problem.

Perhaps most importantly, SIBs and the Young-Delaney legislation have the opportunity to help change how cities, States and the Federal Government support the social sector by persuading them to fund what works.

Thank you.

[The prepared statement of Mr. Schaeffer follows:]

Thank you Chairman Reichert, Ranking Member Doggett and all the members of the Committee for your efforts to highlight Social Impact Bonds (SIB) as a tool that can bring new resources to address some of this country's most pressing social problems. Although SIBs are a relatively new financing mechanism, they have the potential to help scale some of this country's most effective social programs and help government focus funding on interventions that have proven results and save taxpayer dollars. The recent legislation introduced by Congressmen Young and Delaney would catalyze all levels of government to address issues ranging from prisoner reentry to homelessness to early childhood care by directing funding only to programs proven effective through rigorous, independent evaluation.

My name is Sam Schaeffer and I am the Executive Director and Chief Executive Officer of the Center for Employment Opportunities (CEO) an organization devoted exclusively to meeting the employment needs of men and women with histories of incarceration. The testimony I am submitting is principally on behalf of CEO, but I also hope to offer the perspective of the field of reentry employment as well as nonprofit providers who use data-driven approaches to address social problems impacting communities across the nation.

Background on Center for Employment Opportunities and NYS SIB Project

CEO began as a demonstration project at the Vera Institute of Justice in New York City. The organization became an independent nonprofit in 1996 and since that time has helped more than 18,000 men and women coming home from prison find full-time jobs to support themselves and their families. The CEO program has been proven through random assignment evaluation to reduce recidivism and make impacts on the employment of high-risk individuals. Over the last five years, CEO has leveraged its evidence and expertise to expand to 10 jurisdictions across Oakland, San Bernardino and San Diego, California; Albany, Buffalo, Binghamton and Rochester, New York; and Oklahoma City and Tulsa, Oklahoma. Today, the organization serves more than 4,200 people returning from incarceration each year, placing more than 2,000 in full-time, private sector jobs where they will earn more than $30 million to support themselves and their families.

In December 2013, CEO began a SIB project that serves individuals in New York City and Rochester. This transaction was the result of more than a year of planning between the State of New York, Social Finance US (SF) and CEO. The parties' strong collaboration was driven by shared purpose: help serve 2,000 high-risk men returning from prison over the next four years. Forty-four private investors provided capital for this transaction. If CEO hits benchmarks on reducing prison and jail bed days, along with additional employment outcomes, the investors will be repaid by the US Department of Labor and New York State. This is a performance-based contract. But instead of focusing on *outputs* like job placements, it hinges on our organization making an *impact* on recidivism and long-term employment. This SIB deal was one of the first in the United States. Yet the early learnings from this project already present policy makers, service providers and intermediaries with knowledge that can help other transactions successfully tap new capital that will maximize taxpayers' investment in government-supported services.

The Problem: Direct and Collateral Consequences of Incarceration

Let me begin by giving the context for CEO's work and explain why attracting new capital to prisoner reentry through vehicles like SIBs is critical. The United States incarcerates more people than any country in the world; around 2.4 million at last count. Half of this prison population is under thirty years old; more than 600,000 are young adults between the ages of 18 and 25. This morning, seven million children woke up across the country with a parent in jail or prison or living

under criminal justice supervision. All this comes at a great cost: the United States spends $64.3 billion every year on incarceration. While budgets for corrections departments have soared, there has not been a corresponding investment in reentry to assist people coming home from prison in order to stop the costly cycle of crime and incarceration.

Nearly everyone who is incarcerated in prison, approximately 95 percent, will eventually be released. Over the last decade that has consistently meant that we have 600,000 or more chances a year to help people turn their lives around and make neighborhoods and communities safer. Still, recidivism rates are stubbornly high: more than 40% are reincarcerated and more than two thirds rearrested within three years. There is a strong correlation between unemployment and recidivism: a study in New York found that 89% of people who were re-incarcerated were unemployed at the time. We fail too frequently in helping people reenter their communities successfully. This failure has a profound impact on public safety and communities impacted by crime and incarceration.

The CEO Model

At CEO, our mission is to turn those statistics around and break the cycle of crime and incarceration through a proven and cost-effective employment model. CEO's vision is that *anyone* returning from prison who wants to work has the preparation and support needed to find a job and stay attached to the labor force. This creates safer communities and healthier individuals and families, all at a fraction of the cost of incarceration. CEO's model consists of four phases that participants move through at their own pace, enabling each person to address their own unique barriers to employment.

Phase I: Recruitment and Job Readiness Training

CEO targets the highest risk, hardest to serve individuals. We recruit directly from parole officers, ideally within the first 90 days of release. Everyone who comes to CEO is unemployed. We don't screen for attitude, education or experience. Our ideal client is someone who needs a job and is likely to fail in their reentry without a targeted intervention. 43 percent of our participants are young adults, under 25 years of age. Nearly 1 in 2 is a parent. Half have never worked and only 10% have any education above high school or its equivalent.

CEO's program begins with a brief Life Skills Education course in the first week, where participants learn best practices for applying to jobs, interviewing and overcoming the stigma of a conviction. CEO also works with participants to procure all necessary identification documents, removing a frequent barrier that prevents them from legally stepping onto a job site and receiving a paycheck.

Phase II: Transitional Employment

After graduation, participants receive a pair of steel-toed boots and a work ID and are immediately eligible to begin working on a CEO transitional job site. Across the country, our social enterprise has 60+ work crews that provide basic maintenance and custodial services to public and private sector customers. For example, in New York City, crews maintain eight college campuses in the City University system; in Oklahoma, they are helping rebuild homes after the tornadoes that hit Moore last year; and in California the crews perform litter abatement for CalTrans. The crews work in groups of 5-7 people and are overseen by a CEO site supervisor. Individuals can work four days a week. At the end of every shift they are evaluated on their work performance and given a paycheck for the day. Working for CEO on a supervised work crew gives participants an opportunity to earn

income within one week of enrollment while learning basic workplace skills and developing the tools they need to rejoin the permanent workforce and rebuild a life without crime.

Phase III: Full-time Job Placement
Concurrent with working a transitional job, CEO participants receive a full suite of vocational services. CEO uses the experience gained on transitional work sites to develop participants' competencies and place them in jobs with permanent employers. CEO's dedicated Business Account Managers focus on building relationships with local businesses and filling job orders to match participants to employer specifications. Businesses value CEO as a ready source of job-ready labor that can fulfill their hiring needs.

Phase IV: Job Retention
CEO recognizes the tenacity required of program participants to remain connected to the workforce. To that end, participants receive retention services from CEO for a full year after job placement. Retention services include workplace counseling, crisis management, job redevelopment after job loss, and career planning. An incentive-based program, *Rapid Rewards*, provides monthly payments to enrolled participants who attain job retention milestones.

CEO Evaluation
CEO has replicated this model with fidelity in sites across the country because we know it works. In 2004, CEO participated in the U.S. Department of Health and Human Services' Enhanced Services for the Hard-to-Employ Demonstration and Evaluation Project. As part of this project, the independent evaluator MDRC conducted a three-year random assignment evaluation of CEO that also included a sophisticated benefit-cost analysis by the Vera Institute of Justice.

The evaluation of CEO[1] is one of the most rigorous tests of an employment program for former prisoners in recent years. **The three-year evaluation found that CEO significantly reduced recidivism.** The largest impacts occurred among former prisoners who enrolled shortly after release from prison, the core group of people targeted by CEO. CEO substantially increased employment early in the study period, and while the employment effects faded over time for the overall sample, CEO had several positive impacts on post-program employment. In general, CEO's impacts on criminal justice and employment were strongest for those who were at higher risk of recidivism when they enrolled in the study. The benefit-cost analysis included in the study shows that CEO's financial benefits significantly outweighed its costs.

The study of 977 former prisoners used a rigorous random assignment design, comparing outcomes for individuals assigned to the program group, who were given access to CEO's services, with the outcomes of those assigned to the control group, who were offered basic job search assistance at CEO along with other services in the community with the exception of transitional jobs.

The Results: Program Impact

- **CEO significantly reduced recidivism with the largest impacts for the group of participants recently released from prison.** This group was significantly less likely than

[1] This information was summarized by the National Transitional Jobs Network from MDRC's final evaluation report. The full report is available http://www.mdrc.org/publications/616/overview.html.

control group members to be arrested (49 percent, compared with 59 percent); convicted of a crime (44 percent, compared with 57 percent); or incarcerated (60 percent, compared with 71 percent). These impacts represent a reduction in recidivism of 16 to 22 percent across the three outcomes. Such reductions in recidivism are difficult to achieve and have rarely been seen in rigorous evaluations similar to this one.

- **CEO's impacts on employment and recidivism were stronger for those who were more disadvantaged or at higher risk of recidivism**. Among the subgroup with four or more prior convictions at the time of study, CEO reduced convictions for new crimes by 12.8 percentage points. For CEO participants without a high school diploma and for those considered to be at high risk of recidivism, there was a reduction in the number of days spent incarcerated. For those at high risk of recidivism, post-program (years 2-3) average quarterly unsubsidized employment increased by 11 percentage points (27 percent of program group members compared to 16 percent of the control group).

- **CEO substantially increased employment in year 1; for the recently released subgroup CEO had some positive impacts on post program employment but the effects were less for the overall sample.** First year improvements in employment outcomes were substantial (24.5 percentage points) driven by participation in transitional jobs. In years two and three, on average, recently released program group members had more quarters with unsubsidized employment than their control group counterparts (19 percent of program group members worked seven or eight quarters, compared with 11 percent of the control group). At the time of the evaluation, it should be noted, CEO had only just begun its retention services program. Over the last 9 years, CEO has doubled its internal 180- and 365-day job retention outcomes.

- **CEO's financial benefits far outweigh its costs.** The total financial benefits of CEO were as high as $3.85 for every $1 invested in the program. Put another way, the total financial benefit equaled $10,300 per person served. Over 80 percent of CEO's cost impacts were taxpayer benefits that came in the form of reduced criminal justice expenditures, primarily due to lower utilization in prison and jail beds. When viewed through the lens of taxpayer benefits only, the financial benefits of CEO were still as high as $3.30 for every $1 invested in the program, or $8,300 in savings for every person served.

Pay for Success: Overview

The CEO evaluation illustrates that by providing intensive employment services for those at higher risk of re-offending, as close to release from prison as possible, employment reentry can increase public safety and be part of our economic solution. The SIB project that CEO is currently implementing in New York State builds directly on these principles. The project plays to CEO's programmatic strengths, allowing us to deliver the model we have refined over the last 30 years to those individuals who most benefit from the intervention. Further, CEO's strong evidence base and clearly defined outcomes gave investors the ability to assess the risks and rewards of their investment.

In this $13.5 million SIB transaction, CEO will serve 2,000 high-risk men recently released from prison and returning home to New York City and Rochester, New York. If individuals in the treatment group spend at least 8 percent fewer days in jail or prison than the control group, and

show at least a 5 percent increase in their immediate and long-term employment, the federal government and the State of New York will return investors a portion of the savings. Returns for the 44 private investors financing the project can reach as high as 12.5 percent. However, if these targets are not met, investors stand to lose their capital.

The Value of PFS Financing for Providers

The opportunity for CEO is significant: receive unrestricted capital to deliver our core program to the population for whom we make the deepest impact. CEO typically finances its operations through a diverse set of government and private funding streams. While our economic model has helped us build a financially stable and sustainable organization, the resources we receive from this SIB project are unique in that they pay *the full* unit cost (currently $6,000) of each person we serve. Never before has CEO received funding that pays the entirety of per-person costs at this scale. What's more, we are not required to provide a match or conduct any additional fundraising for the project. Receiving these resources upfront, on a quarterly basis, allows CEO to concentrate on providing excellent services and alleviates the burden of fundraising.

Certainly, there are risks. Random assignment evaluation, scaling up, and multi-year, multi-million dollar contracts all require significant preparation and due diligence for nonprofits. When we began there was no playbook, road map or learning community to guide us through the intricacies of scoping this project or bringing the deal to closure. CEO was able to manage potential financial and reputational risk by forging strong working relationships with our partners in both New York State and SF. Mutual interest in the project's success drove trust and collaboration between all parties. Each entity brought particular expertise to the deal making process and had a strong interest in seeing this project succeed.[2]

Role of Intermediary

While CEO has experience with performance-based contracts and scaling-up, in size, scope, and complexity, this project is like no other we have taken on in the past. To finalize the project design and contract, we worked closely with the SF and New York State for more than a year. SF gave CEO the space to provide meaningful input in the project and evaluation design, helping us align the SIB project with our proven program model. They also brought significant expertise in the capital raise, directly marketing the deal to private investors. This work was clearly outside of our expertise and would have presented a distraction were we required to participate in it.

SF's role has remained critical since the project launch. CEO prides itself as a national leader in nonprofit performance management, but has gained an invaluable thought partner in SF. Weekly calls with SF and the state have given us the opportunity to jointly look at data and spot issues before they become a problem. For example, we were able to make minor corrections to the referral process in order to continue hitting enrollments targets. Their continued support and involvement will be critical for this projects' success.

PFS: Project and Evaluation Design

As mentioned, the program intervention at the heart of this transaction is the core CEO model. The only deviations to the model are minimal, and if anything, are likely to enhance the project's impact.

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[2] For a discussion on how CEO navigated risk in this transaction, and tool that other providers can utilize, please see: Schaeffer, Samuel "Assessing Nonprofit Risk in PFS Deals," http://www.ssireview.org/blog/entry/assessing_nonprofit_risk_in_pfs_deals

Jeffrey Liebman of the Harvard Kennedy School and Director of the Harvard SIB Lab designed the evaluation for this project. The evaluation will be administered by the New York State Department of Corrections and Community Supervision (DOCCS) and validated by Chesapeake Research Associates. DOCCS is responsible for randomly assigning individuals into the treatment and control groups. The randomization occurs in the weeks before an individual is released from state custody. After the list of participants is generated, it is sent to CEO, Social Finance and NYS parole officers. All study group participants will be at a high-risk of recidivism, as assessed by COMPAS, a validated Risk/Need Assessment tool.

Immediately upon release, CEO Outreach Specialists and Parole Officers (part of DOCCS) meet together with each treatment group member. In a "Matched Candidate Meeting" (MCM) individuals are told they have been selected to enter CEO based on their need for employment services. During the MCM, the participant is introduced to CEO's program and scheduled for the next orientation – generally within a week. This coordinated messaging helps reinforce the collaboration between CEO and Parole and is unique to this project. The Outreach Specialist continues to follow up with the individual until they enroll at CEO. After enrollment, the participant receives all CEO services beginning with Life Skills Education and extending through Transitional Work, Job Placement and Retention Services. This pinpointed recruitment of high-risk, recently released individuals and the MCMs have long been aspirations of CEO. Only by working in such close partnership with DOCCS in this SIB project was CEO able to target its services to those individuals for whom this program has been proven most effective.

Performance Measures and Repayment[3]

DOCCS will track the employment and criminal justice outcomes of all treatment and control group members. There are three performance measures in the NYS transaction that can trigger repayment:

- **Recidivism:** The marginal cost of an additional day of incarceration in NYS, either in prison or jail, and the cost to victims of crimes associated with those incarcerations.
- **Employment:** Greater tax revenue and reduced public assistance costs as a result of increased employment.
- **Transitional Jobs:** Value to the public sector due to services provided through CEO's transitional jobs in government buildings.

Again, the project must achieve a minimum performance threshold before investors are eligible for a performance-based payment for that metric. If the intervention's impact falls below all of these levels, then investors will not be repaid. Table 1 describes the performance threshold that must be met or exceeded to trigger payment for each outcome metric.

Table 1. Minimum Performance Thresholds Required to Trigger Payment

Outcome Measure	Minimum Performance Thresholds
Reduction in Recidivism	Avoided Bed Days >= 36.8 (~8%)

[3] The tables in this section were originally published in "Investing in What Works: "Pay for Success" in New York State Increasing Employment and Improving Public Safety." The text draws heavily from document as well. http://socialfinanceus.org/sites/socialfinanceus.org/files/Detailed%20Summary%20of%20NYS%20PFS%20Project.pdf

Engagement in Transitional Jobs	Avoided Bed Days >= 36.8 (~8%)
Employment	Employment Rate Difference >= 5 Percentage Points

The project's outcome pricing methodology ensures that the government's performance-based payments are never more than the savings and benefits estimated to result from the project's impact. Phase I represents the first two years of the project; Phase two the second two years.

Table 2. Public Sector Savings and Benefits Calculation

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)

Payment Schedule

For each outcome metric that meets or exceeds the performance threshold, the public sector savings and benefits are included in the calculation of performance-based payments. For Phase I and Phase II, the performance-based payment will be the sum of:

- 100% of public sector benefits and savings for employment, not to exceed $2,000,000.
- 100% of public sector benefits and savings for recidivism and transitional jobs outcomes up until the amount of the original investment in the applicable Phase ($6,832,000 for Phase I and $6,668,000 for Phase II).
- 50% of public sector benefits and savings for recidivism and transitional jobs beyond the value of the original investment for the relevant phase.

The total performance-based payment is capped for Phase I at $11,095,000 and for Phase II at $10,448,853.[4]

[4] For Phase I, the maximum performance-based payment is the difference between the $12,000,000 US DOL grant awarded to NYS and the $905,000 state and validator costs. For Phase II, the maximum performance-based payment is the difference between $11,000,000 state funds allocated for this project and the $551,147 in state and validator costs.

Recommendations to Facilitate a Robust National SIB Infrastructure

Social Impact Bond financing has the potential to bring much needed investment and market principles to some of our country's most pressing social problems. Increasing work for the long-term unemployed, preventing child abuse and neglect, and ensuring successful prisoner reentry are a few of the areas that SIB projects can address. And there are so many more creative and important proposals being considered by governments across the country. Yet, thus far there are only five transactions in operation. Each has been tailored to particular issue-areas and geographies. As Tracy Palandjian, co-founder and CEO of Social Finance, has said, "If you have seen one Pay for Success deal, you have seen only one Pay for Success deal."

Still, there is much we can learn thus far from the work of government, providers and intermediaries. As government at the local, state and federal level consider support for new and exciting projects, there are several tenets to be absorbed from early adopters. Congressmen Young and Delaney's legislation recognizes several of these principles and makes clear that Congress and the federal government can play a leadership role in the development of the field. Below I offer recommendations that can help this nascent field continue to expand and innovate.

Recommendations Regarding Providers, Evaluation and Performance Thresholds

- **Select experienced, proven providers.** At this early stage of SIB development, it is important that projects select service providers with extensive experience implementing an evidence based model. This means that their work must be proven through experimental or quasi-experimental studies. In the future, SIBs may be used to fund more speculative interventions, but for the field to gain steam we need to construct transactions around service models and providers that have a measurable impact on a particular issue.
- **Choose performance and repayment metrics carefully.** Performance thresholds must be achievable based on a provider's capacity and track record of performance. Transactions should only aim to achieve results that are consistent with providers' historical performance, not in excess of it.
- **Don't overlook fidelity and performance management.** Demonstrating impact through rigorous evaluation is a significant achievement for a provider. Replicating that impact consistently, year-after-year can present a challenge. The success of SIB projects rests on the ability of providers to implement interventions *with fidelity* to a proven model. Additionally, providers must be capable of managing performance to achieve pre-determined benchmarks of a particular PFS project, especially in the face of unanticipated external challenges (e.g. insufficient referrals). To do this effectively, they will need support in collecting meaningful data and assessing their program fidelity by independent evaluators. The must also have the capacity to utilize robust performance management tools.
- **Build on evidence.** In the NYS transaction, CEO and its partners identified subgroups in its original MDRC evaluation where it made the deepest impacts (high risk and recently released parolees) and designed the SIB intervention specifically around this group. The approach is helping CEO achieve the greatest social value for its participants, while allowing government and investors to achieve the greatest financial impact. Other projects should take the lessons of their previous evaluations, and design projects that maximize efficacy and public return on investment.

Recommendations Regarding Capital Investment

- **Make the capital flexible and unrestricted.** Too often, providers receive grants and contracts that pay only a portion of the actual expenses required to deliver services. As a result, time and energy is diverted away from running the program to fundraise for the shortfall. SIB projects have the potential to address this challenge head-on by providing flexible capital to providers that accounts for the actual cost of services. Continuing this approach can strengthen the financial sustainability of providers while allowing them to invest more time and resources into high-quality programming.
- **Attract new capital; don't cannibalize.** One of CEO's interests in participating in a PFS project was accessing new forms of financial support that were previously unavailable. Diverting existing government and/or philanthropic sources to our project would have lessened its appeal – that would be simply supplanting funding. We wouldn't want a foundation to rescind an annual grant and start investing those resources in a SIB. SIBs should offer us the chance to grow the pie of funding, not just cut it differently.
- **Facilitate multiple payor projects** Many social interventions save money across multiple levels of government. Prisoner reentry, for instance, might save a county the cost of jail bed days; a state, the cost of prison bed days; and the federal government might have reduced healthcare expenditures. Coordinating a transaction – and evaluation -- across three levels of government is challenge, but if the field is going to grow it will be important to develop a way for multiple levels of government to partner and reap the benefits of a SIB deal.
- **Cost benefit is key, but it's not the only thing.** Providers like CEO that work in the criminal justice space are well suited for SIBs. Over a relatively short time horizon, our impacts can be monetized based on outcome measures like averted jail and prison bed days. Interventions focusing on violence reduction or literacy, for example, may show impacts, but the monetary benefit may be less clear. These projects should have a place in the SIB landscape if they can prove through rigorous evaluation that their program is definitively making an impact *and* it is an outcome that government values. Saving money is one of the chief advantages of SIB projects, but we should also find a way to support projects with clear societal, if not exclusively monetary, benefits.

Recommendations to Help Grow the Field

- **Government champions are critical.** There are a handful of key players in every SIB deal: government(s), providers, intermediaries, evaluators and investors. For a deal to come to closure *and* be successfully operationalzed, strong government leadership is essential. Government will often need to coordinate referrals or service delivery with the provider. Only deals that can demonstrate strong government leadership should be considered for participation in this space. This means government must be committed as a payor, but also an operational and performance management partner.
- **Help providers become deal-ready.** As mentioned above, there are only a handful of active SIB deals nationally. Many more are in the pipeline, but for the field to scale, more providers will have to enter the market. To do this, government needs to provide technical assistance and support to help providers become deal-ready. This should come in the form of support for performance management training, investment in data collection systems, and fidelity assessments. Philanthropy should continue the active it has played in capacity building as well.
- **And assist them in managing risk in deal-closing.** For those providers who are ready to participate in SIB transactions, they will need the support of intermediaries and potentially

outside counsel to wade through the technicalities of evaluation design, investment terms, and other areas that might fall outside the bounds of their expertise.

Conclusion

SIBs provide a promising vehicle for evidence-based interventions to scale-up and provide solutions to challenges facing communities across the country. Not all social problems can be solved by SIBs and not all organizations are capable of successfully navigating the rigorous process of deal construction. In a resource scarce environment, however, SIBs allow government to support projects only when a proven intervention has show real results to a specific social problem.

But there is even more to SIBs than maximizing taxpayer return. SIBs can help fundamentally transform performance in both government and the social sector. I see several ways in which this is already happening. First, the rigorous evaluations attached to these projects will help us build a robust evidence base of what really works. Second, as nascent as SIBs may be in the United States, the impact of their presence is already resonating throughout the social sector. Philanthropy has been compelled to support organization's efforts to become SIB ready by building their capacity and evidence base. These efforts will benefit the sector as a whole by building stronger providers, regardless of whether or not they lead to a SIB deal being executed.

Perhaps most importantly, SIB projects have the opportunity to fundamentally change how government works by placing an emphasis on funding high-performing, evidence-based interventions. SIBs and this legislation have the ability to bring about a sea change in government behavior, persuading cities, counties states and the federal government to fund what works. SIBs can promote an ethos that will push local government agencies to acclimate themselves to this performance or outcome based approach to contracting. Finally, SIBs are not an end unto themselves. Providers who can demonstrate their success in SIB deals should have preference in future government contracting. While the mechanism is groundbreaking, as important is the idea that we fund based on performance. We can start doing that today. Now is the time to start.

Chairman REICHERT. Thank you, Mr. Schaeffer.

Mr. Romo, please.

STATEMENT OF ROBERT ROMO, FORMER CLIENT, CENTER FOR EMPLOYMENT OPPORTUNITIES

Mr. ROMO. Good afternoon, Mr. Chairman, and members of the House Ways and Means Committee.

My name is Robert Romo, and I am very excited, very proud, and a little bit nervous to be here. Thank you so much for inviting me and letting me share my story.

I was released from prison after doing 13.5 years, and 3 days out my parole officer gave me two options for employment programs to attend. The first program required me to wear a uniform that made me feel uncomfortable and reminded me of prison. I wanted to take my shot with CEO.

As soon as I started CEO, I felt positive about gaining employment sooner than I thought. Everything felt professional from the first day. It felt good to come to class every morning at 7:00 a.m., to have a place to go that made me feel positive about myself.

My life skill instructor consistently treated us like equals every day. It never felt phony, and I got my attention right away. She truly believed in me and pushed me to accomplish things that I was not sure I could. She instilled in me to do my best every day and to believe that my conviction did not define me.

I was taught that presentation helps define who we are. I learned how to interact appropriately and professionally on the job. I learned self-confidence, and the CEO staff helped build my self-esteem. My job coach worked with me doing mock interviews. She never said my ways were wrong, but encouraged me to look at a different way of expressing my way, myself.

I worked for 6 weeks on a part-time transitional job site doing maintenance on college campuses. I got a paycheck at the end of the shift, which was great. It helped me buy extra groceries to support my family.

At the same time, I was attending the carpentry program at the CEO training center two nights a week. CEO kept me busy. There was not a lot of leisure time, which was very good, because staying busy meant I was not tempted by bad habits and old acquaintances. I was totally focused on my future.

None of this was easy, but my instructors motivated me, pushed me and believed in me 100 percent. I had to get good grades on multiple tests and have good attendance to have CEO pay my tuition at a local community college for the next part of the carpentry program. I did it. And before the training was over, my job developer set up an interview for me at a hotel, and I was hired on the spot, doing maintenance and carpentry.

I kept in touch with CEO because they told me I could and should do something I love, not get stuck in just any job. I love construction. And they sent me on another interview. And again, I was hired on the spot.

On that job, I met someone I knew while incarcerated. He told me about an opportunity with his window company and set up a meeting with his owner. I was planning to go in a suit, but my CEO job developer suggested I should dress like I was ready to

start work that day. And I did. I was hired on the spot. I have been there since last October and have already participated in building two sites.

Honestly, I could not have achieved all of this without the support of CEO. They helped me see beyond my conviction to a future that was really positive. I am grateful for the second chance.

I always had a passion to help others who are in a similar situation, and CEO is helping me fill that dream. This opportunity to speak today is just a first step towards fulfilling that goal.

Thank you again for having me here today.

[The prepared statement of Mr. Romo follows:]

Good Afternoon Mr. Chairman and members of the House Ways and Means Committee. My name is Robert Romo and I am very excited, very proud and a little nervous to be here. Thank you so much for inviting me and letting me share my story.

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As soon as I started CEO, I felt positive about gaining employment sooner than I thought. Everything felt professional from the first day. It felt good to come to class every morning at 7am, to have a place to go that made me feel positive about myself. My life skills instructor consistently treated us like equals every day. It never felt phony and that got my attention right away. She truly believed in me and pushed me to accomplish things that I was not sure I could. She instilled in me to do my best every day and to believe that my conviction did not define me. I was taught that presentation helps define who we are. I learned how to interact appropriately and be professional on the job. I learned self-confidence and the CEO staff helped build my self-esteem.

My job coach worked with me doing mock interviews. She never said my way was wrong but encouraged me to look at different ways of expressing myself. I worked on a part-time transitional job site doing maintenance on college campuses. At the same time, I was attending the carpentry program at the CEO training center, 2 nights a week. CEO kept me busy; there was not a lot of leisure time, which was very good because staying busy meant I was not tempted by bad habits and old acquaintances. I was totally focused on my future.

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fuel that dream for me. This opportunity to speak today is a first step toward fulfilling that goal. Thank you again for having me come here today.

Respectfully Submitted,
Robert Romo

Chairman REICHERT. Well, if I can call you Robert.

Mr. ROMO. Yes, sir.

Chairman REICHERT. Robert, you did an awesome job. So we couldn't even tell you were nervous.

Mr. ROMO. Thank you, sir.

Chairman REICHERT. You did very well. And we are so happy to have you here. And I imagine that there were times in your life where you probably didn't have much hope at all in getting a job, and here you are. You were hired on the spot at least three times.

I have never been hired on the spot my first applications in my previous career. And so congratulations on your success there. And I bet a few years ago you would never have thought you would have been—would have had the opportunity to testify in Congress. Right?

Mr. ROMO. Absolutely, sir.

Chairman REICHERT. Yeah. Well, you—as I said, you did an excellent job. You should be very proud. And we are happy to have you here today.

Mr. ROMO. Thank you so much, sir. It means a lot.

Chairman REICHERT. You are welcome.

Ms. Gibbs, you are recognized for 5 minutes.

Ms. GIBBS. That is a hard act to follow.

Chairman REICHERT. Yes, it is.

STATEMENT OF LINDA GIBBS, PRINCIPAL, BLOOMBERG ASSOCIATES

Ms. GIBBS. Good afternoon, Chairman Reichert and Ranking Member Doggett and members of the Ways and Means Subcommittee on Human Resources.

I am Linda Gibbs, principal at Bloomberg Associates, which is a non-profit consultant group that was established by Michael Bloomberg to support mayors in achieving their visions for the citizens of the cities they serve. Before joining Bloomberg Associates, I served as the New York City Deputy Mayor for Health and Human Services.

Working in City Hall with Michael Bloomberg, we focused closely on poverty in New York City. The Young Men's Initiative was a key part of that work and—which was focused on reducing the disparities for young men of color across all social domains. The Nation's first social impact bond was born out of that initiative as we searched for funding sources to help commissioners to launch innovative strategies to meet the mayor's challenge.

The goal of our SIB is to reduce future jail time among adolescent inmates who are held on Rikers Island. We know from historic data that this population has a shocking 1-year recidivism rate of 50 percent. Half of them will be back on Rikers within 1 year.

We were determined to change this outcome, but that left us with a question of what was going to prove the most promising model. While we had many post-discharge programs in place, we wanted to explore a jail-based strategy to counteract the negative effects of incarceration itself on later criminal behavior.

We settled on an evidence-based cognitive behavioral therapy program called Moral ReconationTherapy, which emphasizes changing negative patterns of thinking as a way to reduce harmful,

self-destructive antisocial behaviors, and has evidence that demonstrates reduction in recidivism in the range of 15 to 30 percent where it has been evaluated across the country.

We adopted this. We called it ABLE. And we worked with two proven non-profit providers to deliver the service, MDRC, a national research and evaluation shop, and Osborne Associates, who had a long history of work on Rikers Island. The independent Vera Institute of Justice will serve as our evaluator and will be monitoring the success of the program.

Goldman Sachs fully funds the project's intervention by advancing a $9.6-million loan to MDRC. If recidivism, meaning return to Rikers, drops by 10 percent, the investor will be repaid the $9.6-million investment.

At the 10 percent break-even point, the City will have an amount necessary to both repay that investment and to pay for the continuation of the program. Drops in excess of 10 percent produce increasing returns to the investor up to a total payout potential of $11.7 million, which—at a recidivism reduction of 20 percent. Everything beyond that would accrue savings exclusively to the City. The investor's benefit is capped at that level.

If the performance of recidivism does not drop by 10 percent, a portion of the investor's investment will be protected by a guarantee fund provided by Bloomberg Philanthropies, which will protect part, but not all, of the investment.

We have completed the first full year of service, and results on the reductions to recidivism will be calculated after a full year expires from the treatment cohort's exit from prison. We need to watch a full year after they leave to know what the recidivism rate is for those that received the service. The program is funded to continue for 4 years, and the evaluation will continue for a full 7 years. So that is our program.

Reflecting now more broadly on the issue of social impact bonds, I believe the model has great potential for a number of reasons. You have heard many of them already.

SIB funding frees up the creative thinking process and can really stimulate innovation, the potential that the resource brings to the table. And it not only brings private capital forward to fund social programs, it directs a flow of capital to areas that current private markets typically do not serve: high-need communities without liquid access to private markets.

SIBs also advance promising strategies. SIBs can help evidence-based projects being tested in one place to more easily jump government boundaries for replication elsewhere, and SIB investors can facilitate the scaling up of what works locally.

Less attention has been given to what I believe is a different and very significant benefit, that is, that SIBs elevate the tenor of outcome-based management in city halls and State houses, advancing skills and defining clear outcomes, measuring for results, and assessing governmental cost and benefits.

In many ways, I believe the SIB's greatest potential for government is that it is bringing this expertise to the table. Particularly for small jurisdictions without the ability to invest in large research capacities, the field of SIB practice is making straightforward tools more broadly accessible.

But SIBs are not a panacea. They are not appropriate, for instance, when the intervention will not produce government savings. There are many social programs that should and need to be done, but just require an outlay of government expenditure or philanthropic investment. So SIBs will not serve every purpose.

Other programs produce savings, but they take too long for them to be realized to be relevant in an investor's timeframe or they are too dispersed to be easily recouped, although I would note that the Young-Delaney bill, 4885, would solve part of that problem by making it easier to recoup those Federal savings that do accrue.

Two other cautions I would note. Without good data management systems, evidence cannot be produced to satisfy the rigor of the model. Over time, I would expect this will improve as government agencies become more adept and systems are more widely available at reasonable costs.

Great expertise is developing in structuring programs to be administratively simple and increasingly well structured to avoid practitioner bias, but this is also an emerging expertise and design considerations are significant.

And this effort is in its infancy. Transaction costs can still be high and prohibitively high for many. Again, as skills develop and tools proliferate, these barriers should drop, making the practice more widely available.

In sum, I am optimistic that SIBs offer great potential to move the field of sound social service practice forward, providing well beyond the short-term benefits of new investment dollars to providing sound outcome-based management expertise.

Thank you.

[The prepared statement of Ms. Gibbs follows:]

Bloomberg Associates September 9, 2014

Statement of Linda Gibbs
Principal, Bloomberg Associates

House Committee on Ways and Means, Subcommittee on Human Resources
Hearing on Social Impact Bonds and Families in Need

Chairman Reichert, Ranking Member Doggett, and Members of the Ways and Means Subcommittee on Human Resources, good afternoon. Thank you for the invitation to testify today from the perspective of a local government on the potential of social impact bonds, which I believe have great potential to advance the effectiveness of government services.

I am Linda Gibbs, a principal at Bloomberg Associates, a non-profit consultancy created by Michael Bloomberg to support mayors in achieving their visions for the citizens of the cities they serve. We apply our expertise across eight practice areas and are now working in nine jurisdictions around the world, at no cost to the Mayors we advise. Before joining Bloomberg Associates, I served for thirty years in New York City government, and in the final eight years as Deputy Mayor for health and human services.

Working in City Hall with Michael Bloomberg we focused closely on the current causes and potential solutions to poverty In New York City. The Young's Men's Initiative was a key component of this work, in response to the Mayor's request that we identify strategies to reduce disparities for young men of color in the city. The nation's first social impact bond in New York City was born of that initiative, as we searched for funding sources to help commissioners launch innovative strategies to meet the Mayor's challenge.

Social Impact Bonds (SIB) are a type of Pay for Success (PFS) contract, but with a public-private partnership financing model that funds tested preventative programs at no cost to the taxpayer, improving social outcomes and ultimately saving taxpayer dollars. Private investors fund a program's delivery and operations (often administered by a nonprofit intermediary) under a contract in which government commits to paying the investors back with interest if and only if improved social outcomes are achieved that generate taxpayer savings. A reliable third-party evaluation determines if the program has achieved prescribed outcomes before government makes any "success payments."

This unique financing model is gaining momentum, and there's widespread interest among governmental bodies across the USA and internationally, largely due to the fact that it represents a new way to bring private sector capital to advance social change. However, I believe the potential benefits from SIBs to advance the effectiveness and efficiency of government services is much larger. The first SIB was implemented in the United Kingdom and recent results announced the initial success of the Peterborough SIB in meeting the threshold target by reducing recidivism rates by 8.4%, exceeding the threshold target of 7.5%. The NYC project which began in 2013 was the first in the United States.

The goal of the NYC project is to reduce future jail time among adolescent inmates who are held in our jail on Rikers Island. The reduction in future jail time is associated with savings to the city's Department of Correction, in the form of shutting down unneeded housing units. After negotiations among all parties, projections of impact were established based on the national research of programs akin to the one we adopted, adjusted based on local population data. Specific "success payments" are tied to different levels of impact and associated government savings.

Allow me to explain the program. At the time we began, we estimated there would be approximately 3,400 youth who would experience a stay at Rikers in a single year. We know from

historical data that this population has a shocking one-year recidivism rate of nearly 50%, a mean length of stay of 65.3 days, and an average of one prior incarceration at the DOC.

Our goal in the Young Men's Initiative was to make a significant difference in this outcome. The question was what might work to improve their chances when they left our custody? While several programs have been adopted as part of the Young Men's Initiative, one in particular captured our imagination. What if we fundamentally restructured their experience while they were in our custody, strengthening their social skills and assisting their ability to make more responsible decisions when they returned home? Providing a group program in a jail setting, we believed, had the potential to improve group dynamics and counteract the negative effects of incarceration on later criminal behavior.

We started with research on what programs have evidence of succeeding in this goal, with this population. Most therapeutic programs like what we had in mind are operated in prison settings, for populations that already have been sentenced. We differ in that the vast majority of our youth are held pending the outcome of their trial. And they are young, just 16-18 years of age.

We settled on an evidence based cognitive behavioral therapy called Moral Reconation Therapy. The term "cognitive behavioral therapy" (CBT) is a general term for a range of therapies with similar characteristics. These therapies emphasize changing negative patterns of thinking as a way to reduce harmful, self-destructive, and antisocial behavior. CBT has been found to be effective in decreasing substance abuse and reducing criminal behavior. It has been tested in prisons across the country and shown to reduce recidivism rates and improve participant behavior. There is a large evidence base for cognitive behavioral therapies. The Vanderbilt Institute for Public Policy Studies conducted a meta-analysis of 58 experimental and quasi-experimental studies on the effects of CBT on the recidivism of adult and juvenile offenders. The study found that in a 12-month follow-up period individuals in the treatment group experienced an average reduction in recidivism of 25%.

The specific version of CBT being implemented at Rikers is known as Moral Reconation Therapy (MRT). Moral Reconation Therapy (MRT) has a particularly strong evidence base that offers the unique advantage of being an "open curriculum" well suited to the Rikers environment. Unlike other CBT models, MRT offers a lot of flexibility in delivery. For example, groups are open-ended, which means that new clients can enter a group at any time and be meaningfully incorporated. Youth can also move at their own pace through the curriculum. Finally, while the full program is designed to be completed in about 10 weeks, benefits accrue in as little as three weeks. Given that youth move in and out of Rikers frequently and that many inmates will leave before a course is complete, enter after a class has started, or need to switch to other another class, this flexibility of the MRT program is critical.

There is also a strong evidence base for moral reconation therapy specifically. Of the thirteen studies reviewed for us by MDRC, out intermediary partner in the project, seven showed positive and significant effects (others showed either positive but non-significant effects or had design flaws). The Cognitive-Behavioral Treatment Review published a 1994 experimental study on the effectiveness of the MRT model. The five-year recidivism rate for MRT participants was 41% compared with 56% for non-participants (a 15% percentage point difference – that is, 27% lower than without the program). Program participants had lower levels of criminal involvement at all follow-up periods on all indicators of recidivism. The Portland State University's Division of the Administration of Justice released an evaluation on the outcomes of MRT for juvenile offenders in which three percent of MRT participants were re-indicted compared with 13 percent of non-participants.

Based on this research, we adopted the MRT model, and worked with the program founders to formulate its application in the adolescent housing on Rikers. We named the program ABLE (the Adolescent Behavioral Learning Experience). To deliver the program, we worked with a non-profit organization with deep ties to work on Rikers Island, the Osborne Association, and supported them with technical assistance from MDRC.

MDRC is a research and demonstration intermediary organization. Under one roof, it houses the capacity to design, develop, and oversee the implementation of new and existing approaches to complex social and behavioral problems, as well as the capacity to rigorously evaluate the effectiveness of these initiatives. In this project, they will only be exercising their programmatic proficiency in designing and overseeing ABLE.

It is not a guaranteed outcome however. This intervention has never been implemented in a setting as large and complex as Rikers. And as mentioned earlier, this is largely a pre-adjudication population, not one serving time for crimes for which they've been convicted.

The Vera Institute for Justice, serving as an independent evaluator contracted by the city, will be monitoring the success of the program. Vera will be assessing the program service delivery, examining factors related to program enrollment and level of participation in MRT, and determining whether the program has been effective at reducing future jail time. Program payouts will be based on those independently verified outcomes.

The financial terms are key to social impact bond arrangements. In our case, the intermediary, MDRC, working on behalf of the investor, will be reimbursed through a pay-for-success reimbursement system that has been established in contract negotiations. The payout terms in the contract require that payments be made only when Vera validates that performance outcomes associated with future jail time savings have been met.

Here are the terms of the agreement. Goldman Sachs fully funds the project's interventions by advancing a $9.6 million loan to MDRC. If recidivism, meaning return to Rikers, for the group receiving the service, drops by 10%, the investor will be repaid the full $9.6 million investment. At the 10% breakeven point, the city is assuming a reduction of around 560 beds (from cohorts 1-4 over a 7 year period) which translates into anywhere from 4 to 6 housing units. This breakeven point was identified as the amount necessary to be saved to both repay the investment and to have sufficient savings to pay for the continuation of the program.

The loan is secured by a Bloomberg Philanthropies grant of $7.2 million, which is held by MDRC in a guarantee fund. Consistent with the manner in which many foundations make program-related investments, Bloomberg Philanthropies is helping to reduce the risk for a private investor to participate by establishing this guarantee fund. If the reduction is less than 10%, the grant dollars in the guarantee funds will be used to repay a portion of Goldman Sachs' initial investment. Ultimately, $2.1 million of the Goldman investment is at risk, 25% of its principal, if the full guarantee fund of $7.2 million from Bloomberg Philanthropies is depleted. If the guarantee fund is not needed, those funds will be available to support further social impact investments. But any return on the initial investment – triggered by cost savings from reductions in the recidivism rate – will go exclusively to Goldman Sachs or remain in the fund for future social impact projects in NYC; Bloomberg Philanthropies receives no financial return on its investment.

As the program works, the Department of Correction's savings accrue and that money is used to make the payout to the intermediary. Lowering Rikers' recidivism rates will yield significant savings for the city since these costs are all borne by the city without state or federal participation. Drops in excess of 10% produce increasing returns to the investor, as well as additional savings to the city, capping for the investor at a payment of $11.7 million if recidivism drops by 20%. For Goldman, this return on its investment is comparable to returns on its other community development loans. At that point the city will also be saving over $20 million from the improved outcomes from the young people involved, again beyond the savings sufficient to pay the investor and continue payment for the service on Rikers. Any drop beyond 20% and savings that accrue are retained exclusively by the city.

I believe this model has great potential for a number of reasons. It:

o Unleashes creative potential. Innovation in government can be challenging, particularly when there is little prospect that funding is not available to support new approaches. The possibility for SIB funding can free the creative thinking process and stimulate innovation;

o Shifts risk for funding new programs from government to private investors. Government can be risk averse. This financing model transfers risk to private investors so that taxpayers have no liability if a program does not reach successful outcomes – in other words, taxpayers pay nothing if the tested program does not work. The City only pays for programs that result in positive social outcomes and cost savings. In order to incentivize private funders to take the upfront risk, the city is willing to pay a return, similar to bond investments to build bridges and tunnels;

o Brings private capital forward to fund social programs. Government dollars are tied up in programs that represent the consequences of poor outcomes – jail, shelter, remediation. Funding for strategies to prevent those outcomes is scarce and there is reluctance to raise taxes to cover those costs, particularly without strong confidence the preventive strategy will work. SIB financing bridges that gap. SIBs also direct a flow of capital to areas that the current private markets typically do not serve. The charities and NGOs who implement the work receive funding to work in neighborhoods where people do not have the liquid access to private markets seen in the more mature or affluent neighborhoods;

o Advances promising new strategies. There is often reluctance in adopting new practices imported from the experience of others, on the belief each jurisdiction is nothing but unique. SIBs heavy reliance on evidence can help evidence based projects being tested in one place to more easily jump governmental boundaries;

o Creates opportunities to scale up programs. Similarly, pilots with strong research results often have trouble spreading and going to scale. SIB investors can facilitate the spread of what works in support of programs that have evidence to back them up;

o Elevates the tenor of outcomes based management in city halls and state houses, advancing skills in defining clear outcomes, measuring for results, and assessing governmental costs and benefits. There are many reasons government managers will give for not moving to evidence based practices – "It's too complex, we don't have the skills to do that, we don't have the data to do that, you can't measure social outcomes, what you can measure are not the right outcomes, etc, etc, etc. Shifting the focus of government management from "this is how it's always been done", to 'this is how to get the best results" needs focused and forceful advocates, and SIBs can be a powerful inducement to that goal;

o Invests in skill development for government program managers. In many ways I believe SIBs greatest potential for government is that it is bringing to the table expertise in data management, evaluation, evidence based practice and cost-benefit assessments. Particularly for small jurisdictions without the ability to invest in large research capacities, the field of SIB practice is making straightforward tools more broadly available, and the investment in this knowledge development will have benefits well beyond SIB project management; and

o Aligns all parties around a set of clearly defined, measurable outcomes with payment only for success. SIBs have a greater degree of accountability for actual results, driven by the contractual terms for repayment. While many programs government invests in are done of the promise of great future benefits and returns, except for academically leaning research studies, none have the same sharp focus on precise outcome assessment. This again is an area where SIBs have the potential of advancing social program management beyond the SIBs themselves, as this skill level develops broadly.

But SIBs are not a panacea.

o They only work where government is willing to pay investors for their risk. And this is best where cost savings accrue. That will not be true in many circumstances. Many urgently needed

social programs will continue to need to be done because it is the right and smart thing to do, despite the fact they produce no savings.

- Other programs that produce savings which take too long to be realized to satisfy an investor's timeframe, or are too dispersed to be easily recouped, are not suitable for SIB financing, although I would note that HR 4885 would solve part of that problem by making it easier to recoup the federal savings that accrue.
- Without good data and management systems, evidence cannot be produced to satisfy the rigor of the model. Over time I would expect this will improve as government agencies become more adept at data management and systems are more widely available at reasonable costs. Great expertise is developing in structuring programs to be administratively simple, and increasing well-structured to avoid practitioner bias. But this is also an emerging expertise and design considerations are significant.
- The effort is in its infancy, and transaction costs are still high, prohibitively high, for many. Again, as skills develop and tools proliferate, these barriers should drop, making the practice more widely available.

In sum, I am optimistic that SIBs offer great potential to move the field of sound social service practice forward, providing well beyond the sort term benefits of new investment dollars, to providing sound outcome based management.

Chairman REICHERT. Thank you.
Mr. Juppe. Is that pronounced correctly?
Mr. JUPPE. "Juppe." Yes. Thank you.

STATEMENT OF DAVID JUPPE, SENIOR OPERATING BUDGET MANAGER, MARYLAND DEPARTMENT OF LEGISLATIVE SERVICES (DLS)

Mr. JUPPE. Good afternoon, Chairman Reichert, Ranking Member Doggett, and Members of the Subcommittee.

My name is Dr. David Juppe, and I am the senior operating budget manager with the non-partisan Department of Legislative Services in Maryland. I have spent the last 25 years analyzing operating and capital budgets and making recommendations on fiscal policy.

I got involved with social impact bonds in 2012 when a former colleague, Kyle McKay, who is now with the Texas Legislative Budget Board, began examining a proposal by Maryland's Department of Public Safety and Correctional Services to utilize a social impact bond for reentry program funding for the purpose of reducing recidivism by at least 10 percent.

So I will talk a little bit about the findings of our paper briefly. As mentioned, there are a number of potential benefits for social impact bonds, but since it is a fairly new financing mechanism, you should also be aware of some of the concerns and issues that counteract some of the proposed benefits.

I am not terribly surprised that social impact bonds would be considered at this point. Since the great recession of 2008, governments at all levels have been cutting back spending, and certainly it could be expected that providers would be seeking a long-term source of revenue. So you have—various mechanisms like social impact bonds, public-private partnerships and the like are gaining in popularity.

Some of the risks that we would raise for your attention, at least consideration—first off is, you know, there is the higher cost to government for social impact bonds.

Governments can and do procure contracts and services from private non-profit vendors through competitive procurements and single-source procurements every year and pretty much pay simply a direct cost, whereas, under a social impact bond, you have not only the direct costs, you have the potential for return on investment costs, costs for independent evaluations, as well as additional costs, such as management fees for intermediaries that link the financing with the providers and with governments.

Related to this is the question of whether or not governments can really avoid having funding upfront provided in their budgets annually in terms of appropriations. One issue related to this is the fact that, when you look at State and local government budgets, typically they are—they build a request based off of their base and they often get a request ceiling or a target for the next year.

So it would be very difficult—or more difficult certainly in this constrained fiscal environment for a level of government to provide 10, 20, $30 million above its base funding to pay a multi-year social impact bond payment.

Certainly you would also expect that investors would like to see some sort of security. I mean, certainly, when purchasers of government-issued debt, either GO bonds or revenue bonds, see some sort of security in the forms of debt service reserve accounts, the bonds are insured or you may see debt service coverage ratios, but right now the only security you have is the expectation that, potentially, governments will appropriate the funds.

A second issue that I would raise has to do with overstated cost savings and the likelihood of success. I have seen a number of proposals over the years, boot camps, community courts, drug courts and the like, social impact bonds.

In many instances, there is a—it seems like there is a proclivity to taking the total cost of a facility, dividing it by the total number of cases, and deriving a cost per case and claiming that is a savings.

So, for example, you may have a prison where it costs roughly $30,000 per offender. That includes all fixed and variable costs. So the savings from 100 inmates would not be $3 million, as you might expect with the simple math. Typically, unless you shut down an entire wing or entire facility, you really only save the variable cost of food, supplies and medical costs. And in 2012, when we did our study, the variable cost was about $4,600 for offender in the Maryland prison system.

So just—in short, just to say about our summary of our findings, we looked at a program that would involve 250 offenders and we estimated costs of $4.1 million over 5 years against savings of about $250,000. So that pilot project would end up costing the State about $3.9 million.

Also, with social impact bonds, we have a concern that short-term incentives could skew results to try to ensure success so that the investors get their return. And this could include selecting the most treatable offenders—or cases, a short-term focus on getting results as opposed to maybe longer-term programs, and, again, I think a flight to safety, so the potential for focusing on programs that you know are successful so there is a greater likelihood of investors getting their money back.

One other issue I would simply raise is just the risk versus the rate of return. We are seeing in social impact bonds a number of different negotiated on case-by-case rates of return. 13 percent in Peterborough. I think I saw 22 percent on one of other social impact bonds.

And, you know, in the bond market, risk of non-payment is measured by bond rating agencies, and you also have, you know, a number of other factors, such as the length of the maturity and so forth.

With social impact bonds, you know, for a short-term program, it seems like the rate of return can be fairly inordinate and—especially if there is a flight to safety and there is not as much risk or, in instances where—in New York City, where a portion of social impact bond was guarantied by the Bloomberg Foundation, then risk is very slight indeed.

In closing, I have included in my written testimony some considerations for the legislation that you have before you. And I will just close by saying that social impact bonds do carry some risks, and

in addition to the benefits, I think that, you know, you need to weigh carefully both the good and the bad here.

Thank you.

[The prepared statement of Mr. Juppe follows:]

Good afternoon Chairman Reichert, Ranking Member Doggett and the Members of the Subcommittee. My name is David Juppe and I am currently employed as the Senior Operating Budget Manager with Maryland's Department of Legislative Services. In this capacity I have analyzed operating and capital budgets for 25 years in a non-partisan role. I also teach a graduate class in public sector budgeting for the University of Baltimore's MPA program. In 2012, working with my colleague Kyle McKay, our agency evaluated the proposed use of Social Impact Bonds by the Department of Public Safety and Correctional Services. I appreciate the opportunity to address the subcommittee on the findings of our review of Social Impact Bonds and my observations on their benefits and risks.

Background

Social Impact Bonds represent a new variation on public sector performance-based contracting with private or non-profit providers. Unlike the traditional model, Social Impact Bonds introduce third party financing to provide multi-year funding to the providers. Advocates of this arrangement suggest that the following benefits accrue to each party:

- Providers receive a guaranteed multi-year stream of revenue to support services;
    - Providers can use this funding to develop new and innovative programs to address certain public policy goals;
- Successful outcomes lead to a return on investment to the investor(s);
- Government agencies do not need to provide any payment up front and instead only pay if successful outcomes are achieved; and
    - Program risk is said to be transferred to the private or non-profit sector. If outcomes are not achieved the government does not need to repay investors.

Why Social Impact Bonds? Why Now?

The concept for Social Impact Bonds originated in 2010 at the Peterborough Prison in the United Kingdom. Investors would receive a rate of return based on specified reductions in the rate of recidivism. Since then, several states in the U.S. are either implementing or considering Social Impact Bonds as a financing mechanism.

My opinion is that spending cuts by all levels of government following the "Great Recession" of 2008 have resulted in a reduction in contracts and thus limits to the cash flow of private and non-profit service providers. Social Impact Bonds appear to offer an alternative revenue stream to maintain or increase government contracts without the limitation of up-front government appropriations. Similarly, public-private partnerships have also gained in popularity as cash strapped governments lack the capacity to issue additional debt for large capital projects.

Risks

There are several risks associated with Social Impact Bonds. These include:

1. Higher costs to the government**:** On their face it is difficult to see how Social Impact Bonds are more advantageous than traditional direct contracts between government agencies and providers. Successful program outcomes under the Social Impact Bond model will lead to the

payment of a return on investment, which can exceed a double digit rate of return, in addition to the standard direct service costs[1]. This is in addition to expense for independent evaluation.

Another aspect highlighted by Kyle McKay is that governments are not likely to realize up-front savings due to a need to appropriate program costs annually to ease investor concern about payment. As a result, funds will be encumbered until program outcomes are achieved.[2] This is also a likely necessity for most government agencies given the difficulty agencies may face in securing a lump sum payment for the total costs of a multi-year program.

2. Overstated cost savings and the likelihood of success**:** In Maryland I have seen many proposals for new programs in the last 25 years, all designed to improve policy outcomes and produce cost savings to the State's budget. An all too common mistake stems from a "fixed cost fallacy." This fallacy involves dividing the total number of cases, such as the average daily population of a prison, into the total cost of the facility or agency. For example, a proposal may assume an estimated savings of $30,000 per year for each individual who is not returned to incarceration. This assumption, however, overstates the savings unless an entire facility were to close. In this example, the actual savings is the variable cost per inmate for food, medical costs, and supplies. When Maryland conducted its study of Social Impact Bonds the variable cost per inmate was only $4,600. Thus a program designed to reduce readmissions by 100 inmates would not save $3,000,000 a year (100 inmates times our hypothetical $30,000 total per capita cost) but would instead only save $460,000 (100 inmates times the annual variable cost per inmate of $4,600).

The study that we conducted in Maryland's looked at reentry programs that were designed to reduce recidivism in the adult prison population. We assumed 250 annual program participants, with a projected outcome that recidivism would be reduced by at least 10%. This outcome assumption was more optimistic than the outcomes demonstrated to date in Peterborough. The study found that instead of producing savings, the program would cost the state $3.9 million.[3] Many of the interventions considered in social impact bond programs are valuable tools in a broader set of policies. But social impact bonds will not typically produce savings that are large enough to justify the added expenses of the model compared to traditional methods of finance.

3. Short-term incentives that could impact outcomes: Due to the pressure to succeed it is possible that Social Impact Bonds could be subjected to some of the following problems:

Creaming/self-selection bias: Programs may seek to initially treat the easiest cases or those deemed most likely to succeed;

Short-term focus: Programs may also be developed which produce short-term results, in lieu of alternatives which could lead to greater long-term savings. More importantly, a program may appear to be successful based on one study or over a short-term but may over time turn out

[1] Department of Legislative Services, "Evaluating Social Impact Bonds as a New Reentry Financing Mechanism: A Case Study on Reentry Programming in Maryland," (Annapolis, MD: January 2013) 3.
[2] Statement of Kyle McKay on Social Impact Bonds Government Performance Task Force U.S. Senate Committee on the Budget, (1 May, 2014), 1.
[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/341684/peterborough-social-impact-bond-report.pdf

to be an unsuccessful approach. It takes time to evaluate and refine programs in order to determine their true worth. For example, Maryland implemented a military boot camp style program in its prison system in the early 1990s that combined rigorous exercise, job training, education, and job placement. Inmates volunteered for the six-month program in lieu of a longer sentence. Initial results were encouraging, but over time it was determined that in Maryland and other states such programs were not an effective method of reducing recidivism. Maryland ended its boot camp program in fiscal 2010. The point is that the value of research accrues over time, not in a single evaluation, so expecting a single evaluation to conclusively prove a new concept is too simplistic;

Flight to proven programs instead of innovative programs: Even though advocates suggest that Social Impact Bonds will result in the development of new and innovative treatment strategies, it seems more likely that the pressure to produce results will instead have the opposite effect. It seems more likely that established treatment methodologies would be pursued in order to attract investors.

Another aspect related to this point is that governments currently possess the means to use the private or non-profit sectors to identify and implement new and innovative strategies. The State of Maryland, for example, is currently in the process of soliciting proposals to construct a new light rail line linking New Carrollton to Bethesda. The proposals are to be structured to permit maximum use of innovative approaches to build and operate the transit line.

4. Long-term risks: Unlike in the private sector where an investor may not have much recourse, it is possible that unsuccessful investors may petition their elected officials for partial or full compensation. Over the long-term, absent positive outcomes, Social Impact Bonds are also unlikely to hold investor interest. If investors select programs that are already known to work, the value to governments would appear to be minimal. Providing investors with a risk premium for bearing little to no risk will simply drive up costs for governments.

5. Measuring risk and calibrating the return on investment: Currently there are no standards pertaining to any limit to the return on investment except for whatever is negotiated on a case by case basis. In the bond markets, risk is often assessed by bond rating agencies. Greater risk of nonpayment results in higher interest rates (and thus higher costs to the issuer). According to the daily paper *The Bond Buyer* even lower rated 5-year bonds (e.g., Baa on August 26, 2014) paid yields of 2%. Why should an investor in a short-term Social Impact Bond be compensated with a double digit rate of return?

Issues to Consider for Legislation

Proposed legislation pertaining to social impact bonds should address the following:

- Would funds be provided in the form of grants, loans, or loan guarantees?
- Would the federal government be acting as financier of total program costs or a portion;
  If only a portion is to be funded with federal dollars, how will that amount be determined/limited?
- Will the evaluation of outcomes ensure that variable costs are used to determine the actual savings, instead of total per capita costs?
- Should there be a limit on the level of investment return?

- Would treatment populations be subject to fully randomized selection to limit bias?
- How will it be determined how much the federal government shall receive in the event of cost savings?

Conclusion

Social Impact Bonds represent a new innovation in public sector finance. Proponents suggest that this mechanism offers government the ability to shift risk to the private & non-profit sectors to achieve savings through the implementation of innovative programs. However, as a budget professional with 25 years of experience in state budgets, the benefits to government seem less apparent upon closer scrutiny. Governments at all levels can simply contract directly with providers without paying a return on investment to third party investors. Until a more extensive set of evaluations can provide evidence for the impact and value of social impact bonds, governments should continue to utilize proven methods of operating and financing programs.

Chairman REICHERT. Thank you for your testimony.

Mr. Overholser.

STATEMENT OF GEORGE OVERHOLSER, CEO AND CO-FOUNDER, THIRD SECTOR CAPITAL PARTNERS

Mr. OVERHOLSER. Thank you, Chairman Reichert, Ranking Member Doggett, and Members of the Subcommittee. I am very pleased to be here.

Just by way of introduction, I had a business career. I was on the founding management team of Capital One and then had a venture capital business that I built called North Hill Ventures, but for the past 10 years, I have spent more or less full-time on the social sector.

The one thing that connects all the work I have done is riding on the megatrend that I think is behind the social impact bond discussion and pay-for-success discussion that we are having today, which is the inexorable and very powerful drop in the cost of computation and in the cost of capturing data.

And what we are really seeing here is that, for the first time in history, just as it was true for the credit card industry 15 years ago, the cost of measuring outcomes has gotten to the point where we can actually do performance-based contracting based on outcomes, something which I think we would have done 20, 30 years ago if it were economically feasible. This cost is only going to continue to go down further, especially as we learn the art of performance-based contracting in this subsector.

2 or 3 years ago I co-founded a non-profit called Third Sector Capital Partners. We currently have 25 people, and we spend 100 percent of our time working with partners around the country, putting together pay-for-success contracting that has SIBs as a source of loans for the financing associated with those contracts.

Currently we have about 15 projects underway. And our first project was a $27-million transaction that we helped to set up in Massachusetts, which was based on variable costs.

I think many of the points that Mr. Juppe brought up are highly valid. And we see it as our job to bring scrutiny to these arrangements so that they are of the highest fidelity.

In Massachusetts, it was another recidivism project. In this case, it was helping an intervention that was—it is called Roca, which is a tremendous intervention that could not find its way to scalable funding.

And the pay-for-success approach found a way to get scaling of this program so that 900 gang-involved youth could avoid the terrible obstacle, terrible statistic, of a 60 percent expected prison recidivism rate with an average of more than 2 years in prison.

Each of our 15 projects has an enthusiastic government sponsor behind it. And these people, I have learned, around the country are extraordinarily busy. So why would they take on something so difficult as to basically undergo procurement reform, which is what I believe pay-for-success is about?

And as I speak to them, here are the answers that I hear. First and foremost, these are public servants and they realize the current strategies just simply aren't working for the families in need in this country.

At the same time, they know that there are untapped innovations that are waiting in the wings, and what they are looking for is a mechanism that makes it possible, easier, to surface the best interventions for the families in need and get them implemented at greater scale with greater fidelity and with strong focus on outcomes.

They also realize that they don't have the working capital to get this done. And so they like the idea of lenders coming in. And I should mention that, in our 15 projects around the country, more than half of the money is coming from philanthropists. It is not coming from banks. It is coming from philanthropists who are looking for no return or for an exceedingly modest return.

But what they are able to do is to absorb the risk of failure on these experimental pilots, and that allows public servants, people in government, to go after innovations that they otherwise might not be able to go after and often would never go after.

The other thing that happens is that, bringing in private partners, we tap into human capital. If you work in government, which you do, and I am learning, as someone who is now traveling around the country, there is no one available on that staff to do the hard work of learning how to grapple with data, how to conduct deep due diligence, which is inherent to an outcomes approach. And so the private partners bring human beings who bring this type of expertise that otherwise would not be present, and I think this is very important.

Then the last, probably most important, is having a mechanism in place that recognizes not that something is great now, but it recognizes when a program is no longer working. I would say government is very good at funding stuff that used to work, but it is not very good at recognizing when stuff isn't working anymore.

At Capital One, we did 3,000 tests a year, and what we discovered is that our best innovations rarely lasted. And this was such a profound part of our business that we put posters all over the company of melting ice cream cones. And the poster said, "It melts like ice cream." And what we were saying was, "Whatever you do, don't stop innovating."

What happens, I believe, with the way we do social policy is we have a fund-what-once-worked system. And the joke I like to make is, if we did music the same way we do social policy funding, we would all be listening to Meatloaf on an 8-track recording machine. And that is because 30 years ago Meatloaf was great music.

Not to diss Meatloaf, but 30 years ago, Meatloaf was all the rage and the 8-track machine was cutting-edge technology, and you could imagine someone would say, "This is great. There ought to be a law. Everyone should have access to this. Let's write it up like a recipe card into law and say, 'Anyone who offers this standard of music and this standard of technology will be reimbursed, but if you don't—if you don't follow the recipe, you won't be reimbursed.'"

And that, to me, is a formula for freezing the system, and that is why we are stuck with programs that no longer work.

Thank you.

[The prepared statement of Mr. Overholser follows:]

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Statement of George Overholser

CEO, Third Sector Capital Partners, Inc.

House Committee on Ways and Means, Subcommittee on Human Resources

Hearing on Social Impact Bonds and Families in Need

September 9, 2014

Chairman Reichert, Ranking Member Doggett, and Members of the Ways and Means Subcommittee on Human Resources:

I appreciate the opportunity to testify on Social Impact Bonds (SIBs), Pay for Success (PFS) and their potential to help achieve better results for families in need and communities across the nation. **I strongly support the adoption of House legislation HR 4885,** as introduced by Congressman Todd Young (R-IN) and Congressman John Delaney (D-MD).

As a brief background, I was for ten years a member of Capital One's founding management team and then went on to build North Hill Ventures, a venture capital firm based in Boston. I currently serve as a board member for Vistaprint, Inc., a company that has created thousands of American jobs. But for the last twelve years, I have focused almost exclusively on working within our social sector, helping high-performing nonprofits raise about $350 million dollars of needed philanthropic capital and co-founding a nonprofit called Third Sector Capital Partners, Inc.

Our mission at Third Sector Capital Partners, Inc. is to accelerate America's transition to a performance-driven social sector. We are doing so through our advisory work on Pay for Success (PFS) contracting, and Social Impact Financing (SIF). **PFS is a new form of social service procurement, where services are paid for based on whether or not improvements in social outcomes are actually achieved**. This stands in sharp contrast to traditional social service contracting, where payments are based on a reimbursement concept, and where providers are required to follow certain programmatic recipes as a precondition for payment. SIF is a frequent companion to PFS contracting that involves **private loans (also called social impact bonds) used to bridge the payment timing delays that are inherent to measuring whether PFS outcomes have been achieved.** SIF also plays the vital role of shifting financial risk away from both the government and from vulnerable service providers, and of attracting private stakeholders (particularly valuable for conducting due diligence and maintaining continuity over long stretches of time) into the social services arena.

Third Sector is a leading practitioner in this fledgling industry. We helped launch the Massachusetts Juvenile Justice Pay for Success Initiative, the largest PFS project to date, and have many other PFS/SIF projects in various stages of development. Indeed, PFS/SIF has been catching on rapidly, not only here at the Federal level, but also at the state, county and local levels. To date, there are four launched PFS projects in the country, involving close to $60 million of pay-only-if-it-works government commitments. We estimate that there are at least eleven additional PFS projects in later stage construction, plus fifteen or more in the feasibility assessment stage. The list of **PFS-active states, cities and counties** is diverse and cuts across party lines. It includes **Massachusetts, South Carolina, Ohio, New York, Connecticut, Michigan, Minnesota, Illinois, Utah, Colorado, New York City, Boston, Chicago, Los**

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Angeles, San Francisco, Washington DC, Philadelphia, Santa Clara County, Fresno County, Pima County, Cuyahoga County, Salt Lake County, Alameda County and Orange County.

With millions of lives affected, and $800 billion of annual social spending resources at hand, PFS/SIF offers a potential **breakthrough for America's most vulnerable communities** and for taxpayers at large. It also represents an **opportunity to tap into large quantities of private risk capital**, as well as **private sector expertise** that would otherwise not be brought to bear on important social issues.

Certainly, a **breakthrough is needed**. For many decades, America has been unable to move past the unacceptable conditions (and particularly the underlying causes) that afflict our most vulnerable families and communities. Real **median incomes for the poorest Americans have not budged** over the last forty years, **nor have math and reading test scores**.[1] Why, when we have as a nation managed to double real GDP per capita since 1970 and halve death rates from coronary heart disease, do social outcomes remain so intractable?[2]

Experience has taught me that when we examine the topics like recidivism, foster care, drug addiction, school readiness, homelessness, poverty and the like, we must include government as a key part of the picture. The philanthropic sector is just too small to work alone. For example, during my time at Nonprofit Finance Fund, I helped to raise hundreds of millions of dollars for high-performing nonprofits that worked in these areas. The results of these efforts were gratifying. **But compared to the government resources that were lined up against these same issues, the philanthropic dollars are frankly miniscule.** In this era of mega-wealth and the giving pledge, philanthropy is more powerful than ever; but **if we hope to tackle large social problems, we absolutely need government to be an active partner**.

Several years ago, I began to examine the way government goes about funding social programs and quickly saw that **we currently have a fund-what-*once*-worked** system. In other words, our system of lawmaking and procurement tends to lock old innovations into place, leaving little room (and creating little incentive) for the adoption of new and better approaches. It works like this: At some time and some place, perhaps thirty years ago, a form of social intervention becomes popular. A politician sees the potential and says "You know what, this is a good approach. It ought to be written into a law, so that more people can benefit." After much wrangling, the **program description is written up like a recipe card, enshrined into law, and attached to a spending stream** that says, in effect, "Anyone who follows this recipe will be reimbursed." But – and here's the thing – "If you come up with **some other recipe, you won't be eligible for reimbursement**. So whatever you do, don't change the recipe!"

I have examined the recipe language that is baked into many of our social service laws. Quite commonly, *even after thirty years,* the substance of the recipes remains unchanged. Think of it this way. **If we did music the same way we fund social spending, we would all be required to listen to Meatloaf on an eight-track, or else not be reimbursed.** Because thirty years ago, when Meatloaf and the eight-track were cutting edge, someone would have said, "There ought to be a law!"

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[1] Jon Baron. "Applying Evidence to Social Programs". New York Times "Economix" blog. November 29, 2012, available at http://economix.blogs.nytimes.com/2012/11/29/applying-evidence-to-social-programs/

[2] George Overholser and Caroline Whistler. "The Real Revolution of Pay for Success: Ending 40 years of Stagnant Results for Communities." Federal Reserve Bank of San Francisco Community Development Investment Review; Volume 9, Issue 1, 2014. Available at http://www.thirdsectorcap.org/wp-content/uploads/2013/05/Real-revolution-pay-for-success-ending-40-years-stagnant-results-communities.pdf

I believe that PFS/SIB gets to the heart of this very fundamental flaw to the way we enact social policy. It **replaces follow-the-recipe-or-don't-get-reimbursed with an incentive to come up with better recipes**. And it **connects a rigorous evidence feedback loop to the money**, so that **taxpayer dollars will be better deployed**.

To use the music metaphor, PFS/SIF allows (in fact inspires) the progression from Victorola to 78, to 45, to LP, to eight-track, to cassette deck, to boom box, to Walkman, to compact disc, to iPod, to iPod mini, to the iPhone and Android, to Pandora, to Spotify, and so on. Any single step may not be large, but over time, the "unfrozen" journey leads to a complete transformation.

At this point, I'd like to highlight two promising observations.

First: **The cost of measuring social impact,** *with rigor*, **has plummeted and will continue to do so**. Just as Moore's Law transformed so many other industries, we are now finding that administrative databases, a by-product of running social programs, are finally in good enough shape to be used for social science purposes. As has been well-documented by the Coalition of Evidence Based Policy, it is now possible in many cases to conduct gold standard randomized control trials (RCTs) at a cost of merely a few hundred thousand dollars or less, rather than the many millions we are used to. Moreover, by harnessing administrative data in an ongoing way, we are able to replace one-time RCT "snapshots" with ongoing "movies" of whether or not a social impact strategy continues to achieve impact. Perhaps even more important, we are **now able to construct inexpensive "government-side" evaluation methodologies that establish a common basis for comparisons** across multiple program strategies and service providers. As many lawmakers and government officials have shared with me, the current world of every-provider-brings-its-own-cherry-picked-data makes it almost impossible to discern what truly works for our communities. A common government-side evaluation methodology is sorely needed and, thanks to Moore's Law, is also finally affordable.

The recently revamped **Illinois foster care system provides a striking example** of how built-in, government-side evaluation techniques can be used to insert – at strikingly low cost – a permanent and highly rigorous evidence feedback loop into social service procurement. The idea is simple: In Illinois there are about twenty providers of foster care services for children four and under. With their new approach (and after ensuring an appropriate fit of services and geography) the state uses a rotational assignment system to choosing among providers to serve any given family. Then, using the administrative data that is a by-product of running foster care, each provider is monitored to determine important outcomes such as how many days elapsed before a permanent home was found for the child, or what percent of children served went on to experience trauma. Of course, the work of first implementing this new system was not simple. Procurement reform never is. But now that it is in place, Illinois has a "movie" (not an old "snapshot") of highly rigorous impact evaluation to work with, and a government-side standard yardstick that allows for fair comparisons across their many providers. Because, for all practical purposes, randomization through rotational assignment is now built into the fabric of procurement, and because the outcomes data is already captured as a byproduct, **its ongoing costs are close to zero.** (I should add that a Federal program, the 4(e) Waiver, which enables Illinois to claim half the costs of installing the allocation and tracking systems, was a critical catalyst to making these exciting changes happen.)

Second: As was highlighted in the Chairman's introductory comments, **very few of today's social outlays actually bring about more than a barely discernible amount of impact** on people's lives, whereas **others truly stand poised to make a difference**. This powerful statement, which relates to almost $800 billion of annual outlays,

implies that there is in fact *no shortage of funds*, but rather an **opportunity to reallocate many billions of dollars** towards higher uses.

With these optimistic points –there is a great deal of **wrongly allocated money**, a **newfound ability to measure impact rigorously at low cost**, and **effective interventions waiting to be funded** – it seems to me that we have **no excuse but to move away from the frozen recipe law approach** I described above, and to embrace the newly possible evidence-driven methods of PFS/SIF.

My professional background includes serving on the original Capital One Financial Corporation management team, a company which started in the early 1990s as a consulting assignment for the credit card division of a small Virginia bank. In many ways, the **Capital One story resembles what we are seeing today in the field of social policy**. At Capital One, our strategy was to make empirical testing the centerpiece of our credit card product design and marketing functions. The early days required wrenching change, as we infused data-savvy people into an industry that had never grappled with statistics, and learned how to apply science to the field of credit card marketing. But over the course of just a few years, we got the point where we could **conduct hundreds of rigorous RCT tests per year**, thus learning which few of our many innovations actually worked in the real world. Armed with the proof of rigorous RCTs, we were able to build internal consensus around the winning innovations, and to roll them out with much greater confidence and conviction than would otherwise be possible.

This **strategy enabled Capital One to grow** from a relatively tiny shop to a top-ten credit card issuer within less than a decade. Over one three-year period, **we were the single most-appreciated stock in the New York Stock Exchange**. At the same time, I like to think that we rolled out great improvements in the quality and scope of products offered by the entire credit card industry. Indeed, **just 15 years later, the entire credit card industry had caught up** to employ the same rigorous randomized testing that Capital One pioneered back in the mid-nineties. I believe that a **similar industry transformation could take place in the way government procures many of our social services**. It may be a ten- or fifteen-year journey, as it was for the credit card industry, but this is a journey well worth taking.

From my experience at Capital One, I learned two important lessons that are relevant to PFS. First: **Even our most highly regarded "experts" were unable to predict which innovations would work best**. This meant that the hard work of **relentless empirical testing was surfacing innovations that otherwise would never have been embraced**.

Second: **None of our tested and successful innovations lasted**. Indeed, to remind employees of this fact, we created posters that we put up throughout the company with a picture of an ice cream cone and the slogan, "It Melts Like Ice Cream!" This second lesson is especially applicable to innovations in social services. **Unlike the physical sciences where discoveries like "hydrogen and oxygen make water" stay true forever, the social behaviors are forever changing**. I hasten to add that the issue of melting ice cream was not one, in the jargon of social services, of failing to replicate our innovations with "fidelity to the model". Indeed, our ability to replicate programs was close to perfect, and our statistical sample sizes typically numbered in the tens of thousands. It's just that the world would change, and, over time, the innovations would no longer work.

With these two insights in mind – empiricism trumps intuition and "it melts like ice cream" – it is easy to appreciate why PFS, with its built-in evaluation and powerful financial incentives, has begun to catch on so rapidly across the country. Rather than numbly complying with the tired recipes that constrain traditional spending streams, **PFS shifts**

the focus to achieving outcomes and asks providers and their partners who come up with new and **better ways of addressing social problems**. As a further catalyst for innovation, **PFS shifts the risk of testing new innovations away from taxpayers**, making it **easier for government officials to become champions** of change that works.

Economically, PFS makes it harder for our $800 billion of annual social spending to be squandered, and if Jon Baron is correct in his assessment that 9 out of 10 of these spending streams currently make little to no difference, then PFS can help us to **reduce the waste of $720 billion per year, while redirecting much of that funding towards programmatic strategies that actually do make a difference**.

Social Impact Bond loans help further by creating a new asset class that on the one hand taps into private capital to relieve financial pressures for government and providers, and, on the other hand, offers a **profoundly improved philanthropic proposition for the donors who make SIB loans**. Consider just how much better a deal it is to "donate" to a SIB vs. write a traditional grant. With a traditional grant, you write the check for a program you like and a year or two later you get a thank you letter that says "We've run out of money, can we have some more?" With SIBs, you write a check for that same program you like, and a year or two later you also receive a letter. But this time the letter shares rigorous proof about the difference you made to people's lives *and* there's a check inside that allows you recycle your donation (again and again) towards the program you like so much. I personally believe that there are billions of philanthropic dollars, waiting in the wings that will be drawn to this profoundly attractive proposition.

Critics often point out that there is an added expense to the PFS/SIF approach, and that government ought to just "do its job" and simply fund what works. I have a long list of responses to this. First, something has got to change, because clearly the $800 billion we spend each year is not working anywhere near as well as it ought to. To the contrary, we **cannot afford to continue with ineffective "fund what** *once* **worked/frozen recipe" policy.** We have to measure impact *rigorously*, and we need to do it *continuously*. Second, the **cost of measuring impact has plummeted and will continue to do so**. Third, the **first-time cost of building these transactions is much higher than it will be in the future**, once they can be replicated and once the average size of a transaction becomes much bigger. Fourth, the **financing is actually inexpensive compared to the risk**. Indeed, unless there is close to a 100% success rate on these PFS contracts, government will actually *save* significantly more money (by not having to pay success fees) than will be paid out as interest for the loans. Think of it this way: If a 5% interest loan succeeds, it earns 5%. But if it fails it loses 100%.

As I mentioned earlier, PFS/SIF is **primarily a state and local phenomenon**. But for the state and local efforts to succeed, there is a **critical Federal role** that must be played. For change to happen, cities, counties and states need the catalyst of a Federal bill. HR 4885, introduced by Congressman Todd Young (R-IN) and Congressman John Delaney (D-MD) sets **much needed standards**, it provides the **political impetus** of a match, it pays for **feasibility studies** for which state and local governments have no current funding and, critically, it makes it more possible for state and local PFS initiatives to **incorporate Federal level savings into the cost-benefit analyses** that undergird the PFS model. I am **strongly in support of the bill and hope you will be too**.

Chairman REICHERT. Very good. Thank you, Mr. Overholser.

Those last few words really resonated with me. I don't know if you know my background, Robert, but I was a police officer for 33 years before I came here. So I just look like I have been here 40 years. But I want to visit with you afterwards. I am very proud of you.

And I really agree with the comments that you made, again, at the end. Funding those programs that used to work I think has been a mistake that we have made across the board in a lot of social services and aid and help to families.

So this is why this hearing is so important, to get the good news out about some of the new programs and new efforts that are being made across the country.

And, Mr. Overholser, in—your testimony and your work at Third Sector Capital suggests that this social impact bond financing model has been catching on rapidly at the State and local level.

Is this the case? And why do we need Federal legislation to implement it on a nationwide basis?

Mr. OVERHOLSER. Thank you for the question, Chairman Reichert.

Indeed, I do think there is a great deal of interest around the country. As I mentioned, we have about 15 projects underway, and each one of them does have a government sponsor. I would hasten to add, though, that many of these projects face considerable obstacles that could be addressed through Federal legislation that I will explain in a moment.

The Massachusetts project, I would also mention, had as a major impetus a DOL match that was a Federal match. And, interestingly, that DOL program that challenged States and counties to come up with rigorous pay-for-success constructs caused many, many more applications to be developed, many, many more initiatives and investigations to take place around the country than actually were awarded in the end. In the end, only two of them were awarded. One of them was our project in Massachusetts.

I would also say that the deadline that was imposed as part of that DOL Federal grant created great impetus. I am not sure we would have gotten the project done if we did not have the benefit of that match because it is—there is an impetus that comes if you have a match available from the Federal level.

It allows a local politician to look at folks in the eye who may say, "No. Wait a minute. Why are you spending time on this?" And it allows them to say, you know, "We are able to tap into some funding that we could not otherwise tap into." And even if that funding might be quite small, it changes the discourse.

I would also say that Federal—that this Federal involvement sets much needed standards. Mr. Juppe brought up many pitfalls. If we, for example, in Massachusetts did not look at the variable cost behavior of prisons, that would have been a bad thing. And so I love the idea of having a Federal match that says, "Hey, this match is contingent on quality standards as spelled out in the law."

There is also money there for feasibility studies. It is a modest amount of money. But when you look at local government, that money does not exist. So a very small amount of money for feasibility can unlock major initiatives.

And then, finally, as Linda Gibbs pointed out, many of these social programs around the country, of course, have Federal savings that are generated. So work at the local level can generate savings at the Federal level.

But if you aren't able to tap into those savings and have that feedback loop of the savings, then the cost-benefits don't work, as a matter of economics.

And so the presence of a—and this is sometimes called the wrong-pocket problem—but the presence of a feedback loop that goes up to the Federal spending streams will make it so that more of these initiatives find the cost-benefit that they need in order to be successful propositions.

Chairman REICHERT. You have answered question 2 and 3 as a follow-up question to your first question. So thank you for your answer.

And, Mr. Schaeffer, you talk about the rigorous evaluation of the CEO model and the results of your model. I am going to shorten this up just a little bit because of time.

Given that CEO has been shown to be effective, why should government fund it through a social impact bond and not just contract with you directly, or why not just turn it into a government-run program? Is this just a more expensive way of contracting out, as Mr. Juppe contends?

Mr. SCHAEFFER. Thank you for the question, Chairman Reichert.

You know, I would say, on the one hand, CEO is extremely proud of the evidence base we have developed over the last several years—right?—proving that you can reduce people going back to prison is hard work.

But, on the other hand, I am not sure government at any level—city, county, Federal—has quite caught up in really adopting that ethos of funding what works.

And so this project offers us a tremendous opportunity to build additional evidence, but also build a proof point around really getting government to take hold of this different ethos of funding what works.

And, for us, that is really exciting. And my hope would be, at the end of this project, we would reach really what we could term a performance-based contracting 2.0-type approach where the State of New York, now seeing that we did a really great job, we reduced people going back to jail or prison, would want to contract with us directly. But I would also—it would be, you know, quite understandable at this point that we are not just at that level yet.

I would also say, though, in the SIBs, there is—a tremendous thing that a few of the other witnesses hit on is just the deepness of collaboration that this brings a part between government and a contracting partner.

So frequently we enter into a contract, at the end of a year, end of 2 years, we produce results and—or we don't produce results, and we report back to government.

Given the reputational risks that I think all parties here are taking on, it has been a tremendous experience for us to really work hand in glove with the State of New York to solve operational problems when they arise, to go through everything from how somebody

even comes to our program, to how they get placed in a job, really, with a partnership in government, not just as a contractor-contractee relationship.

Chairman REICHERT. All right. Just jotting down some notes there while you were talking. Thank you so much for your answer.

Mr. Doggett, you are recognized for your questioning.

Mr. DOGGETT. Thank you, Mr. Chairman.

As I indicated in my opening statement, I believe we need to look for innovative ways like this. I wish we had more Bloomberg Foundations across the country to participate in the significant way that your foundation has and the mayor has in New York City.

I am a little concerned, though, about the practicalities and reflect on the experience that my State and some others have had where we were told, if we would just privatize State services and turn it over to some multi-national consultant, we would save a tremendous amount of money, and what has, in fact, happened is that we have had one lawsuit after another as taxpayer resources have been wasted with some of those privatization efforts.

Here the idea of bringing in bond lawyers, consultants, lawyers into the process at a time when we have so many immediate needs concerns me some. In this very committee, we face a situation where we will see major cuts, barring some new budget agreement, in education and social services next year in Federal funding through the sequestration agreement.

The Nurse Family Partnership, funded through the Visiting Nurses, we could extend for about another year at the same price as is reserved in this bill, and, at the moment, we have no funding source for it whatsoever. I think it is a cost-effective program that we need to extend.

In fact, I think every program that we invest in needs to be evidence-based. We should be applying these standards on all government expenditures except for those that we set aside for what are truly innovative programs that we want—where we want to try out a new concept.

Mr. Juppe, my understanding is that your colleague, Kyle McKay, at the Texas Legislative Budget Board, who testified on social impact bonds in front of the Senate Budget Committee earlier this year, reached similar conclusions to yours, that, in many cases, the cost of using the social impact bond outweighed any benefits the State got in modest impact on its cost. Is that right?

Mr. JUPPE. Yes. That is correct.

Mr. DOGGETT. And can you tell us some of the costs associated with establishing and implementing social impact bonds that need to be considered along with the benefits of those bonds?

Mr. JUPPE. Well, yes. In addition to the direct service costs, you have the return on investment at whatever rate that is negotiated. You also have a cost for an independent third-party evaluation to ensure the outcomes were met.

And then, finally, you can also have additional costs for the intermediary in terms of a management fee or a contract for arranging for the financing, the contractor and the government to get together in that social impact bond.

Mr. DOGGETT. It has been suggested that the benefit of social impact bonds—that they will help us grow the pie overall in terms

of State or Federal funding for these programs, and certainly we need to do that. But you pointed out that the States may need to put aside funding to reimburse private investors for these projects.

In terms of State budgets, will social impact bonds actually free up additional funds to invest in social initiatives?

Mr. JUPPE. I think it is actually more likely that government at the State level would have to put aside the funds for the service, plus the additional costs associated with the social impact bond, and then have those funds appropriated each year and then, at the end of each year, encumber those funds for when the actual social impact bond program was completed. So I think there would be additional costs each year.

Mr. DOGGETT. Ms. Gibbs has appropriately noted that these aren't a panacea even where they do work.

Does turning over a decision to private investors about where those dollars will be invested in order to secure a return bias the process of determining what needs will be met and what needs will not be met?

Ms. GIBBS. I don't—I don't see this as a privatization. The thing that is really important to remember is that the relationship of the government and the service is by a negotiated contract between government and a service provider. 90 percent of the social services in New York City are provided in that manner now with non-profit organizations.

So, fundamentally, government is making a decision of what it wants to purchase and under what conditions and the investor is—for social impact bonds is making a determination whether or not that is a risk—a relationship that the investor is willing to take.

But, ultimately, the evidence around what the program's outcomes are, first of all, have to align to the governmental purpose and then, second, for the purpose of whether or not it is a SIB-able event, would have to show the government savings. And the contract itself is up to the government partner to enter into.

So it is not privatization in a private investor who is implementing a program for profit. It is a fundamental non-profit relationship with—the service provider remains in place.

And in the case of the—New York City, we are a GAAP financing jurisdiction. We have to have a balanced budget every year with revenues in, paying for costs incurred. And under those rules, the lawyers determined that the contract payments would not have to be accrued—or recognized in our budget until they actually became due. So there was no obligation to put money up front.

And, in fact, that is one of the beauties of the SIBs, is that the taxpayers do not have to put the money up front. The investors bring in the upfront money and, ultimately, the taxpayers only have to pay if it actually works.

Mr. DOGGETT. Thank you very much.

Thanks to all our witnesses.

Mr. CHAIRMAN.

Chairman REICHERT. Thank you.

Mr. Young, you are recognized.

Mr. YOUNG. Thank you, Mr. Chairman.

I appreciate Mr. Juppe's critical feedback and thoughts on the SIB model, Ms. Gibbs' responses to some of those thoughts, and

would entertain any other thoughts Mr. Overholser or Mr. Schaeffer might have about Mr. Juppe's concerns.

Mr. OVERHOLSER. Yes. Thank you.

I would agree very much with what Ms. Gibbs said about privatization. The 15 projects that we are working on—every one of them begins with a pay-for-success contract between government and a non-profit provider.

And, in most cases, these are non-profit providers who already contract regularly with government and government is sitting at the table and has the decision rights about who the provider is and what the program design looks like. So this is certainly not an outsourcing to private decision-makers of how taxpayer dollars are being spent.

There is a very useful distinction between pay-for-success contracting, which is what we just were describing, and then the SIB. The SIB is just a loan. What it says is that, instead of the provider taking on the risk of maybe never being paid, a group of philanthropists and perhaps some banks as well will provide them a special type of a loan.

And the loan is not to government. The loan is actually to the project itself. The loan will never be repaid if the project fails to produce outcomes because there won't be money to repay the loan. And, so, therefore, these lenders are not like normal bond lenders. They are taking on tremendously more risk.

It is not just the risk of the government failing to honor its obligation, which is called counter-party risk, but there is a much larger risk, which is, in a world where less—considerably less than 50 percent of those social strategies that are put to the test under randomized control trial—considerably less than 50 percent—some people would say 90 percent of those programs bring about no discernible level of impact, meaning you cannot tell the difference between those who are in the program versus those who are not in the program very, very often. This is an extremely high risk of nonperformance that the government no longer needs to take and that providers no longer need to take.

So when we talk about the economics, imagine you spend 10 percent more to put one of these projects together because they are new and it is quite difficult now—I think they are going to become lower than that in the future—but imagine you spent 10 percent more and, instead of 50 percent of them not working, 20 percent of them didn't work. Well, in that case, government would end up spending 20 percent less money because, when it didn't work, government wouldn't need to spend.

Mr. YOUNG. If I could very quickly interject.

Has it been your experience, Mr. Overholser, as—working with the various counter-parties when putting together these series of contracts that constitute a SIB, that government has learned to calculate savings on a net basis, that is, net of management and transaction fees, number one? And have they also understood the difference between variable costs and fixed costs and, thus, factored that into future savings?

Mr. OVERHOLSER. The answer is yes.

Mr. YOUNG. Okay.

Mr. OVERHOLSER. In every case, it is very important to have the economists come in and work through what are the true cost economics.

Mr. YOUNG. Thank you.

Mr. Schaeffer.

Mr. SCHAEFFER. Yeah. I would—I would echo that, sir. You know, we have a current active SIB in New York State in which the State was very focused on ensuring the variable cost rate was considered, and as we consider a SIB in San Diego as well, they are laser-focused on that issue.

Mr. YOUNG. You know, I would further add the issue of giving security to investors in an incipient, inchoate market is certainly very important, and I am glad that Mr. Juppe brought that up.

Based on my field research in the United Kingdom and their work on SIBs, their development of SIBs, they emphasize the importance of allocating money—a pot of money that would offer that additional security—though not essentially necessary, additional security that a contract would not be broken in the future by a future Congress or government. So that has been incorporated into Young-Delaney.

Is there anything additional, Mr. Overholser, that you would add, based on your experiences, to prevent investors from, you might say, gaming the system, that is, trying to reach proven—reach outcomes, that they get their outcome payments, but not, in fact, improving the lives of services? What has been done in the past to prevent this?

Mr. OVERHOLSER. I would begin by saying that the current system is also—you could call it gamed in the sense that the name of the game is to follow the rules that were written in a recipe that probably is very obsolete and that the new game is to try to get the needle to move on a set of metrics that we hope are well chosen.

Very importantly, we must continuously measure outcomes. Very importantly, we must use randomization as opposed to other methods because other methods will invite what some people would call creaming.

And, very importantly, it is helpful to have a market basket of metrics rather than a single metric. As my old friend, the cofounder of Capital One, used to call it, "Beware of monovariabilitis." We don't want to just have one—one variable.

Mr. YOUNG. Thank you. I yield back.

Chairman REICHERT. Mr. Renacci, you are recognized for 5 minutes.

Mr. RENACCI. Thank you, Mr. Chairman.

I want to thank the witnesses for testifying today.

Mr. Overholser, just this year Cuyahoga County proposed a way to help homeless children stay with their own families and avoid the foster care system through the use of social impact bonds. The county spends about 35 million annually on foster care.

I understand the administration has been working with your company. Are you able to share any details on the progress of that program?

Mr. OVERHOLSER. You are speaking of Cuyahoga County?

Mr. RENACCI. Yes. Cuyahoga County.

Mr. OVERHOLSER. Yes. We are very excited about that project. We are making great progress there. And we have, we think, something that is going to be a winner, but we are not—we have not yet come in for a landing. So I am not able to share all the details.

The basic idea there is that homeless mothers tend to have children who are highly involved in the foster care system. And if you think about it—we thought this was a homelessness project until we discovered that investments on the homelessness side actually can affect what is happening over on the foster care side.

So this is a mechanism that makes it possible to do work in one area of government that brings about savings in another area of government and to build a feedback loop. That is that wrong-pocket problem.

The government is very, very poor—does a very poor job, I believe, at being able to take advantage of these interagency relationships, and that is what we are most excited about in Cuyahoga.

Mr. RENACCI. Thank you.

And this is a question for anybody on the panel because I am trying to get a feeling. I mean, what we have here is an intermediary. There is a bond that is the source of funds to do this program and then, if the program is successful, the bonds are paid back with a premium of whatever, 10, 11, 12 percent.

How about the thought—and I just—what is the downside of just contracting for success? What is the downside of eliminating the bond procedure and just contracting for success, eliminating all the fees and coming up with an outright contract that says, "If you do this, you get paid. And if you don't do this"—or, "If you do this, you get paid with a fee. And if you don't do this, you don't get paid," just without—so I would love to hear from any one of you as to what your thoughts are.

Ms. GIBBS. Okay. I am sorry, Sam.

I would say, from—from a government manager's perspective, I, in fact, see social impact bonds as part of a broader family of performance-based contracting. And the world of performance-based contracting, where people are paid in some fashion, their payment is contingent on outcomes, can be everything from 100 percent at risk, only paid if you hit a milestone, or can be a bonus on your payment.

So the difference in those scenarios where it is a 100 percent milestone, it tends to be very input-oriented. You get a payment if you complete an interview with a client. You get a payment if a client enrolls in a training class. You get a payment if a client completes a training class.

The nature of social impact bonds is that they are very much more focused on those longer-term social outcomes, the real good that you are trying to get after. So I would distinguish it that way. Because nonprofit providers simply can't take the gamble around those longer-term outcomes. They don't have the cash flow to wait for those. They need the—they need the revenues now.

Mr. RENACCI. But—not to interrupt, but aren't they taking a gamble on the bonds? I mean, that is where——

Ms. GIBBS. Not the nonprofit providers. The only one who is taking the gamble financially is the investor.

Mr. RENACCI. Well, it is the same. That is what I am getting at. It is intermediary. It is somebody outside of the government that is taking the risk.

Ms. GIBBS. The service—the government and the service provider are not. The investor is.

And the other big difference, of course, is that the social impact bonds bring in new—new cash now versus, if it is a performance-based contract, you have to appropriate the dollar value of that contract in the year that you contract it and with a pretty—pretty much knowledge that 80 or 90 percent minimally will be paid and potentially 105 to 110 percent will be paid, depending on the incentive structure that you have built into your contract.

Mr. RENACCI. Anybody else want to take a run at it?

Mr. SCHAEFFER. Ms. Gibbs gave most of my answer, but I would echo sort of from the vantage point of our project, you know, we are looking at jail and prison bed days, which is a metric that we have no other contract that measures, but it is ultimately the real social good—or one of the two real social good that CEO is achieving.

So as opposed to, say, looking at something like job placements, which was really important—it is what helped Mr. Romo turn his life around—we are taking a longitudinal look at what CEO's impact is 3, 4, 5 years into the future. And SIBs are a great mechanism for looking at those longer-term impactful measures rather than the shorter-term government contract.

And I would add, too, as a provider, we would be very happy to take government contracts that paid us for the full cost of our services. It has nothing——

Mr. RENACCI. If you were successful.

Mr. SCHAEFFER. If we are successful.

Mr. RENACCI. And if you aren't successful, you didn't get paid.

Mr. SCHAEFFER. We get paid up front in this deal. It would be too much a risk for us to take to not enter into something that—where it had such variability.

Mr. RENACCI. Yield back.

Chairman REICHERT. Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

And I am pleased that we are holding this hearing. At the beginning of social impact bonds, I am of a firm belief that the government shoulders the—I am interested in social impact bonds to see if they can leverage public dollars with private investment to expand high-quality prevention programs to improve key social problems.

The topics of the initial social investment bonds are of particular interest to me. The State of Illinois has advanced a pay-for-success program to increase support for youth involved in both the child welfare and juvenile justice systems to improve their outcomes.

Further, part of the President's pay-for-success budget proposal was up to $10 million via the Department of Justice's Second Chance Act, a program that I worked bipartisanly to enact into law to implement the permanent supportive housing laws.

However, I also want to ensure that social investment bonds do not take away funding from existing programs and services that provide critical support to our citizens. I also want to make sure

that the return on investment is reasonable and not a windfall to the investment community.

Mr. Juppe, social impact bonds have been touted as a way to fund innovative programs, but you have suggested that the opposite might be true. In other words, pressure from private investors who want limited risk might steer funding to more proven methods.

If this is true, do you think it is more appropriate to provide direct funding for these proven programs?

Mr. JUPPE. Yes. Absolutely. I would agree that it would be more cost effective to provide direct contracts. There is plenty of examples where governments can, you know, undertake requests for proposals, requests for information with vendors to develop innovative strategies.

Maryland is currently undergoing negotiations with private vendors for the construction and operation of a Purple Line extension between New Carrollton and Bethesda and, as such, is structuring those contracts in negotiations with various interested parties to determine the most cost-innovative strategies for constructing that line and operating it. So certainly you don't have all the additional expense of a social impact bond, which, as we have heard, is really relating to the financing of the services.

Mr. DAVIS. Are you concerned that the returns provided to investors from social impact bonds may not be commensurate with the risks they are bearing?

If mostly proven programs are funded, does this significantly reduce the risk of a project failing to meet performance measures?

Additionally, do you worry that the complexity of the contracts that involve the SIBs might make the balance between risk and reward unclear as well as uncertain?

Mr. JUPPE. Yes. Absolutely. I would agree with that. Certainly as—there is no standard nationally or within States for how you calibrate the risk and the return on investment.

And, as we have seen, for example, in Peterborough, it has been cited as a very complex arrangement and it is unclear entirely how the outcomes will relate to the—you know, the payments to the investors.

For example, in the first year, the recidivism rate has been reduced by 8.4 percent. I believe the first-year cohort required a reduction in recidivism of 10 percent to provide a payment.

So there is no payment for this first cohort, but it sounds like in 2016 there could be a payment if the first- and second-year cohort realizes a reduction of 7½ percent.

So it certainly skews the outcomes, definitely, and—as well as the—there is the concern between how you calibrate the risk and the return.

Mr. DAVIS. Thank you very much.

And, Mr. Romo, let me congratulate you on finding a job and for all of your efforts to create a new life for yourself.

What was the biggest barrier you felt that you needed to overcome in order to secure a job?

Mr. ROMO. Thank you for the question.

I really believe that the tools that CEO provided me with and the mentality that I allowed myself to believe, that, you know, I wasn't

going to be successful anymore due to the time that I did behind prison—I feel that it was—it was—it was helpful and very important because we come out with a low self-esteem and no—no guidance. Don't know how to really find certain—certain responses to be successful and make the transition back into society positive.

Mr. DAVIS. Thank you very much.

Mr. Overholser, you suggested that social impact bonds could reduce the waste of $720 billion per year. That budget figure includes tax relief for working families through the earned income tax credit and child tax credit, Pell Grants for college students, healthcare for veterans, school lunch programs, and long-term care for seniors through Medicaid.

Do you consider any of those programs wasteful?

Mr. OVERHOLSER. I consider them—I consider them programs that could have higher and better use of the same amount of funding. And so my interest is in creating a mechanism that reallocates money towards their highest and best use.

And so many of these programs, yes, could—could have different strategies used that, when put to—to the test, can be shown to be a more efficacious use of that funding.

Mr. DAVIS. Thank you, Mr. Chairman.

Chairman REICHERT. Mr. Griffin.

Mr. GRIFFIN. Thank you, Mr. Chairman.

And I am proud to be an original cosponsor of Mr. Young's bill, and I just want to applaud all the work that Mr. Young, in particular, has done on this issue.

I want to ask you, Mr. Overholser, a little bit—if you would comment a little bit about the value that investors add to a particular enterprise. We heard some talk about directly funding.

It seems to me that the value here of the overall program lies in the value that the investors add to the intervention or the enterprise because, when the government just cuts a check to a nonprofit, there is a different sort of pressure, if any, put on that nonprofit to perform than if you get an energetic investor who uses their own money and shows up at the door every day to check on the progress.

So it seems to me that the investors want to get their money back and redeploy it elsewhere and they bring energy and oversight in a detailed way, what the government almost never provides.

If you could comment on that, if you would. And it seems to me that is a huge—that is a big—there is a big difference there between the government just cutting a check to somebody, and that—therein lies the value—the reason we are having the whole hearing, it seems to me. Can you comment on that.

Mr. OVERHOLSER. I would agree with most of what you are saying. And I guess my view is I would prefer an end game where it is direct contracting.

I would prefer to have a world where government procurement is changed in that the actual human beings working in government acquire the skills that currently we are needing to bring in from the outside.

And I would—I would love to get to the point where providers themselves are on a solid enough financial footing that they don't

need to seek private financing because of their concerns about maybe this thing won't work.

So I see a world, frankly, that doesn't have social impact bonds. It just has pay-for-success contracting. That is where I would like us to get. I believe that, in order to get there, there is a period of time where it is very helpful to tap into what the private side can bring.

That is not present currently in government. And absolutely we are finding that bringing in experts in how to use data better, bringing in experts in how to assess risk better into these—into these project teams is very valuable.

I would also say that the time span of these projects is longer than the—than most political cycles. And so something quite unique about the public-private partnership setup is that, if you have private partners who are working on a 7-year timeframe, they are going to bring a continuity of focus to a project that is absolutely required if you have work that needs 7 years to conduct.

And so the—the cadence of government decision-making, the political cycles are shorter than the absolute truth of what is required to bring about the long-term changes we are looking for in our communities.

Mr. GRIFFIN. I agree with some of what you said, though I am not sure we ever get to this ideal. I mean, you were talking about all the things that you——

Mr. OVERHOLSER. We may never get there. So it is more the ideal——

Mr. GRIFFIN. Yeah. My kids want to live in a world of unicorns and glitter, but that is just not happening.

And we have had decades of either underperformance or failure or—I mean, it seems to me this is—this is reaching outside of the system to bring in proven innovators—even though a particular idea may not be innovation, we are bringing in people who have been successful and who have a stake in the success of this enterprise.

Mr. Schaeffer or Ms. Gibbs, or if anybody else wants to comment, it would be great in my limited time

Mr. SCHAEFFER. Yeah. Absolutely, sir.

CEO would like to believe—and I think we do do a great job on all our contracts. And you are right. To the most extent, it is government cutting us a check and, on a quarterly basis or yearly basis, I will report back the outcomes.

There is something to what you are saying, I believe, in the high-profile nature of this project, in which we are putting our neck out there a little bit, the government is taking a risk, the investors are taking a risk, and that shared interest, I do believe, is driving performance from the leadership of our organization to the case management level.

In Mr. Overholser's world, I would absolutely agree. That is a place that we want to aspire to, and how quickly we can get there, I think, is on all of us to try to figure out.

Mr. GRIFFIN. Skin in the game is what you are talking about.

Mr. SCHAEFFER. That is the right metaphor.

Mr. GRIFFIN. I am out of time. In an ideal world, we wouldn't run out of time.

Chairman REICHERT. Thank you, Mr. Griffin.

Mr. Crowley, you are recognized for 5 minutes.

Mr. CROWLEY. Thank you, Mr. Chairman. Thank you for holding this hearing today.

I appreciate the comments from both sides here this afternoon. And it is great to see some friends from New York here as well. I am proud that New York, both the city level and on the state level, have been so involved in the undertaking of—in some of these projects.

There is a lot we are still learning about the effect of social impact bonds and these types of projects, but I appreciate the fact, as I said before, that New York City, New York State, our leaders are trying new approaches to solving complex problems.

New York State started with a project to reduce recidivism and increase employment among high-risk formerly incarcerated individuals.

And, Mr. Schaeffer and Mr. Romo, thank you for sharing your experiences with these projects.

In New York City, we have also had an undertaking in an effort to reduce recidivism, particularly teen recidivism at Rikers Island, which is in my district. I have seen firsthand the challenges with respect to recidivism at Rikers and the need to find solutions that focus on prevention and long-term strategy.

So I am very glad that we have former Deputy Major for Health and Human Services, Linda Gibbs with us here as well discussing New York City's efforts in these areas.

So thank you all for being here.

These are problems for which there is no easy answer, and I welcome efforts to try and address these challenging social issues. Often we get in the business of reacting to problems rather than trying to prevent them in the first place.

In many cases, it is hard enough ensuring funding for the services that are needed just to respond, such as in the case of assisting individuals leaving incarceration. We appreciate funds for just the immediate need, but don't take the time to stop to consider new and different ways of looking at the overall big picture.

So I am heartened to see that our witnesses today, whether using social impact bonds or not, are trying to encourage new thinking and new approaches to societal problems. And there are a lot more ideas out there and more not-for-profits, State agencies, think tanks, and other groups trying to put ideas into action, which I applaud.

I am glad that this hearing is giving us a chance to think about how best to support these efforts and encourage further innovation. Innovation doesn't mean diverting efforts away from what governments and not-for-profits are already trying to do and the funding that they need to do it, but I am sure there are lessons we could learn from what is being tried and use that information to improve our social programs. And if these initiatives are focusing attention on problems that need more solutions, that is helpful as well.

I know, in addition to the work being done now in helping formerly incarcerated individuals find employment, New York State is moving forward with projects to address other challenges that could have greater effect down the road.

They are trying to address early childhood health and wellness, diabetes prevention, school-based health centers, and providing alternatives to placement and attention for high-at-risk youth.

And none of these problems are going to be solved overnight, and there probably isn't going to be one right answer for every State or city or for every particular—for every problem that is out there. The good news is that we have a lot of people both in this room and outside of it who are interested in working on a solution.

Mr. Schaeffer, in your written testimony, you phrase the effort behind social impact bonds as catalyzing all levels of government to address some of these challenging issues, and I think that goes to the heart of what we are considering here today.

I look forward to continuing to work with all of you and with all of my colleagues on the committee on both sides of the aisle here in Congress to keep exploring ways to promote innovative policy ideas and to keep supporting the organizations that are doing this work all throughout our social policy programs beyond the incarcerated as well. But thank you for your work.

And I yield back, Mr. Chairman.

Chairman REICHERT. Well, that ends—concludes our questioning and our hearing.

I want to thank you all for being here today and sharing your testimony with us. And, as you have heard, there is a lot of interest here. And, therefore, we held the hearing today to help us learn a little bit more.

And there is a number of things that—I kind of like to sum up things from my previous experience. You know, prevention is, of course, one of the things that, in my past life as a law enforcement officer for 33 years, is key, I think, to the success of our society.

And I know that you are all looking for answers to prevent, well, young people, for example, from being homeless and find them loving homes. And we are working on that together here on this committee—subcommittee and as a full committee, you know, and keeping them off the streets and out of drugs, off of alcohol and out of the drug scene, gangs, et cetera.

That is all preventing people from ending up in, you know, a place where Robert was and—but, you know, Robert, those experiences build a man. And you have become quite a man. And so we are very proud to have you. It takes courage to be here today to tell your story. We are happy you had the courage to come and do that because it will help people.

And I know that is where you are today, not only, you know, striving to be a good American with a job and support a family, but you also want to help those who need help, help them from where you came. Right?

So I think we do need to take a look at these things. I—in my previous career, I had the responsibility of being a part of a team who investigated a series of murders in the Seattle area called the Green River serial murders.

Back in those days in the 1980s, those young women on the streets were called prostitutes. Today we know that that is not a correct word. They were criminalized. They were victimized at home. They ran away. And they were victimized again on the street and then they were victimized again by the system.

We have grown as a society and we recognize that these young ladies and sometimes young boys, young girls, are not criminals. They are victims.

And so our system needs to change in that regard as we look at those young girls and young boys on the street who are being victimized as victims and provide those services to them and—just in the same way that we provide services that we talked about today.

So when we talk about innovative, it is almost sometimes just a realization and a growth and a maturity of our community in recognizing that some criminals are not criminals. They are victims, and they need our assistance, they need our help, and they become productive citizens.

Sometimes the Federal Government—I always like to joke when I go back to my district. I know I am going long, but I am on my soapbox.

I go back to my friends at home and I say, "I am from the Federal Government and I am here to help," and they laugh.

We are from the Federal Government, and this committee—this subcommittee is committed to helping in any way that we can. And your testimony today is going to help us decide how we can do that.

So I am required to say, if Members have additional questions for the witnesses, they will submit them to you in writing, and we would appreciate receiving your responses for the record within 2 weeks.

Committee stands adjourned.

[Whereupon, at 3:28 p.m., the subcommittee was adjourned.]

[Submissions for the record follow:]

American Federation of State, County and Municipal Employees (AFSCME), Statement

Statement for the Record
of the
American Federation of State, County and Municipal Employees (AFSCME)
on
Social Impact Bonds: Can They Help Government Achieve Better Results for Families in Need?
before the
Committee on Ways and Means, Subcommittee on Human Resources
of the
U. S. House of Representatives

September 9, 2014

AFSCME has significant concerns with Social Impact Bonds, the "Social Impact Bond Act" (H.R. 4885), and similar Pay for Success (PFS) proposals. In AFSCME's view, claims about the positive impact of Social Impact Bonds (SIBs) are highly exaggerated. We think this approach, as with other privatization plans, would create budget and policy problems for state and local governments and result in harmful privatization of public services. Based on our experiences with varied outsourcing initiatives, we are troubled by the "Social Impact Bond Act" and its $300 million appropriation.

We have had a long history with privatization initiatives, including so-called public-private partnerships, and how they frequently are mismanaged and often suffer huge cost overruns. These budget difficulties give us pause as we consider SIBs, which are new and untested. Moreover, during the subprime mortgage meltdown and resulting financial crisis, many states and localities discovered fiscal problems, which resulted from financial institutions providing dubious investment advice, that was often questionable, self-serving, and sometimes fraudulent. For example, many jurisdictions were trapped in deceptive and costly swaps deals requiring they pay exorbitant fees. These prior outcomes serve as a warning and suggest moving slowly when investors offer no-risk "win-win" opportunities.

Social Impact Bonds appear to be the newest trend in public-private financing, but this does not guarantee positive results. Over the long term, we have seen the pendulum swing from one trend to another. While some see SIBs as a new funding option for states and localities, SIBs' costs are relatively high, their benefits are relatively low, and their many built -in biases would distort service delivery. For example, SIBs favor social service interventions that are shorter-term and relatively attractive to private capital.

It's troubling that SIBs currently require diverting scarce dollars in excess of service delivery costs toward financiers' profits. Instead, any dollars exceeding service delivery costs should accrue to the public. Looking ahead, investors' profit margins on SIBs may need to increase as this market matures. For example, a report by Godeke Consulting found that many investors are uncomfortable being locked into a lengthy SIBs contract and concluded that future SIBs may need to involve more risk sharing — not risk transfer from government. A report by Deloitte and the MaRS Centre for Impact Investing, which surveyed potential Canadian SIB investors, found "many investors noted the requirement for a level of guarantee of the principal investment to participate in a SIB deal."

Thus, it appears either the market for SIBs is smaller than proponents proclaim or jurisdictions will be forced to pay investors relatively higher returns. Some policymakers think as the SIB market evolves, jurisdictions may need to spend more on a project's upfront fixed costs and make some payments – even if the SIB intervention fails.

Our experience also suggests SIBs are likely to decrease transparency and accountability. The public is likely to lose oversight as operations and service delivery are transferred to outside service providers and financial intermediaries are increasingly involved. In many situations, this causes problems for state and local governments, the public interest, and social service recipients.

For the reasons outlined above, some stakeholders view SIBs as an unproven fad in search of funding and private profits. Even key proponents at Harvard's Kennedy School of Government recently said, "there is still much to be learned about how best to structure these contracts and whether they can indeed produce better results for government social spending." We agree that much remains to learn. We are concerned that moving too quickly in favor of SIBs will lead to both expected and unforeseen problems.

Overall, we think state and local governments are typically most effective when they are provided adequate resources, and sensible safeguards are implemented. AFSCME continues to work to ensure that adequate federal resources are available to allow state and local governments to deliver public services and provide necessary infrastructure. We look forward to working with Congress to ensure adequate resources are available.

Thank you for your consideration of AFSCME's views.

American Public Human Services Association (APHSA), Statement

On behalf of the American Public Human Services Association (APHSA), we respectfully submit this statement for the record regarding the September 9, 2014 House hearing on "Social Impact Bonds (SIB): Can They Help Government Achieve Better Results for Families in Need?"

APHSA is a nonprofit, bipartisan organization representing state and local human service leaders for more than 80 years. APHSA's state and local members work to improve the lives of the children, youth, families and adults and simultaneously be worthy stewards of the taxpayer dollars invested in human services programs.

A number of our members have used, or are actively exploring, mechanisms for piloting and testing new innovations such as Social Impact Bonds (SIB) and frameworks for alternative human services financing. These alternative approaches are attractive as a means of improving social services delivery, promoting better outcomes for the populations served by our members, and demonstrating meaningful return on investment to policymakers and the general public. Although Pay For Success (PFS) financing is a fairly new approach, it has become an important potential tool for human services leaders as they consider and test alternative ways to drive state and local innovation and show results.

Prior to the introduction of SIB and PFS models, human service agencies have been focused on similar results-oriented approaches by translating the social value of human services into an investment framework and communicating this value to key stakeholders, including taxpayers, investors, policymakers and community members. These agencies are now considering how SIB and PFS approaches can be used to blend financing, programming and focused attention on outcomes. The PFS approach has the potential to help states and locals move this work forward in a more meaningful and productive way. A number of states have begun testing this concept, and results so far are promising.

APHSA supports legislation like the Social Impact Bond Act of 2014 (H.R. 4885) that assists states and local jurisdictions in providing the capital to leverage innovations and encourage public-private partnerships that combine philanthropic and other private resources with existing public spending. The expanded availability of PFS investment would help more state and local agencies scale up effective social innovations like high-quality early childhood and home-visiting models and community-based programs that promote employment and reduce recidivism. Several other areas in human services could be tested as well.

APHSA's *Pathways* Initiative and the Opportunities Ahead for Human Services Transformation

APHSA's policy initiative, *Pathways: The Opportunities Ahead for Human Services*, was developed in coordination with cabinet-level commissioners of health and human services agencies, along with administrators and program directors from states and counties across the country. The *Pathways* vision involves a fully integrated health and human services system that operates a seamless information exchange, shared services, and a consumer-focused benefits and services delivery system. Our solutions require changing health and human services in a way that focuses on the needs of people rather than compliance with bureaucratic outputs. This requires a new commitment to outcomes over process, and a shared investment among federal and state partners.

The outcomes we seek—and that a revitalized system can achieve—include *gainful employment and independence; stronger and healthier families, adults and communities; and sustained well-being of children and youth.* We know these outcomes can be produced far more effectively, sustainably and efficiently in a transformed human services system.

Our members believe that public human services must move in new directions – down new pathways – to accomplish more effective outcomes in the work we do. There is a broad recognition that programs can no longer continue down an unsustainable path. SIBs and other PFS approaches are a promising way to apply evidence-informed practices and shift government into an outcome-focused and an investment-oriented system.

As a part of APHSA's *Pathway's* initiative, we launched an Innovation Center, which has served as a launch pad for identifying some of those new pathways and supporting our members' efforts to test new ideas and spark innovation. The Center is a "virtual marketplace," highlighting the innovative work

of our members and underscoring the need to introduce and explore cross-cutting approaches driving better outcomes. Social Return on Investment (SROI) and a Framework for Alternative Human Services Financing are a part of this work and are highlighted in the Center. Issue briefs on SROI and alternative financing providing state and local examples and success stories can be found at http://aphsa.org/content/APHSA/en/pathways/INNOVATION_CENTER.html.

State and Local SIB Models Showing Improved Outcomes and Positive Results in Human Services

As indicators of how SIB models can help advance human services to a "next generation" delivery system, we share several examples of noteworthy innovations our state and local members have used to leverage effective practices within human services.

New York City
To significantly reduce recidivism in their criminal justice system and through the Office of New York City's Deputy Mayor for Health and Human Services, the city launched a SIB to measure outcomes and leverage capital investments for the Rikers Island project called Adolescent Behavioral Learning Experience (ABLE). This came at a time when NYC was searching for funding sources to help launch innovative strategies to meet some of the city's criminal justice challenges. This effort called for a reliable third party evaluation to determine if the program achieved the prescribed and agreed upon outcomes before government makes any form of "success payments."

New York City signed a contract with Goldman Sachs to help leverage an initiative that works with youth with criminal histories. ABLE focuses on personal responsibility education, training and counseling. Goldman Sachs invested almost $9.6 million to pay for a new four-year program. Ensuring that they never return to the justice system, the city is striving to lower the chance recidivism for these youth, gain long-term capital gains and save public funds overtime.

Minnesota
Minnesota is currently focused on workforce development and supportive housing pay for performance projects. The state is authorized to use up to $10 million in Human Capital Performance Bonds, which pay providers that demonstrate projects producing a measurable benefit to the state. The state legislature authorized this pilot program through the Minnesota Pay-for-Performance Act of 2011.

Normally, PFS private investors take all the risk; they contribute money up front and are repaid only if the programs they back meet specific goals. Under the Minnesota plan, nonprofits carry the risk. The investors get their return on investment no matter what, but nonprofits get paid only if they succeed. Providers will be paid only upon demonstrating that they have met the agreed-upon outcomes, which must result in savings (or increased revenues) greater than the debt service needed to repay the bonds. In other words, their "return on investment" must be at least 100 percent of the costs of bonding. When they achieve the outcomes, the state pays the service providers and uses the ongoing savings or revenue increases from those programs to repay the debt service on the bonds.

Utah
In August 2013, Goldman Sachs Urban Investment Group (UIG) worked in partnership with the United Way of Salt Lake and J.B. Pritzker. This partnership prompted the first-ever SIB designed to finance high-quality early childhood services. Goldman Sachs and Prizker jointly committed about $7 million to finance the Utah High-Quality Preschool Program. This program provided a high impact and targeted curriculum focused on increasing school readiness and academic performance for young children ages 3 and 4 who presented high needs.

Through this program, it is expected that fewer children will need special education and remedial services from kindergarten through the 12th grade. This results in a costs savings for school districts and state government entities. The first $1 million invested would help approximately 600 children enroll and gain access to high-quality pre-school in the fall of 2013. This program has the potential of generating long-term savings for taxpayers. In addition, the results-based financing structure can become a replicable model for financing early childhood services nationwide. Other states, like North Carolina, are exploring these approaches. The potential savings and impact on potential outcomes associated with special education and remedial services as a young child and the reliance on

government assistance and other services as an adult would be significant. Each scenario also exceeds potential payments to lenders.

University Partnerships
In early 2013, the SIB Technical Assistance Lab at the Harvard Kennedy School of Government, with support from the Rockefeller Foundation, offered technical assistance and support for PFS contracts using SIBs in states. About 28 state and local government applications were received. Seven winners – Connecticut, Illinois, New York, Ohio, South Carolina, Colorado, and Michigan – have received grants.

Through these examples, states and locals are able to see success in their approach for using outcome-based contracts between public and private investors. Through these PFS models, government agencies are able to return investor contributions (with interest) when expectations are met. In return, government agencies are able to provide high-quality services achieving better results and at a reduced cost to the public.

H.R. 4885 would help build on the work represented by these examples and help states and locals replicate these models or pilot other forms of innovation.

The Importance of SIBs and PFS alternative financing

Implementing these approaches would help create a new national narrative about the role and impact of human services. These approaches would support the following:

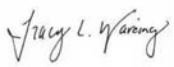
- The measurement of health and human services outcomes and the links between our members' actions and customer achievement of those outcomes.
- A business case for investment in human services that uses monetary and social terms to translate the impact of our members' services.

Recommendations
When considering legislation on SIBs and PFS alternative financing models, we support the following:

- A Federal Interagency Council on PFS to advise the U.S. Treasury Department on specific programmatic and policy matters related to the use of the fund, but Congress must also consider state and local government representatives and related stakeholders.
- Broad scope approaches that allow for a variety of new ideas and flexible funding working across human services programs and related sectors.

Thank you for the opportunity to submit our comments. We look forward to working with Congress to advance broader opportunities to test innovations like SIB and PFS alternative financing approaches for human services programs. If you have any questions, please contact Rashida Brown at (202) 682-0100 x225 or rashida.brown@aphsa.org.

Sincerely,



Tracy L. Wareing
Executive Director

CSH, Statement

Statement for the Record from Deb DeSantis
President and CEO, CSH
www.csh.org

House Committee on Ways and Means
Subcommittee on Human Resources
"Social Impact Bonds: Can They Help the Government Achieve Better Results for Families In Need?"
October 17, 2014

Chairman Reichert, Ranking Member Doggett, and members of the Subcommittee, thank you for the opportunity to submit this statement for the record about the role that social impact bonds and financing can play in supporting efforts to improve the lives of vulnerable populations.

At CSH, it is our mission to advance housing solutions that deliver three powerful outcomes: 1) improved lives for the most vulnerable people 2) maximized public resources and 3) strong, healthy communities across the country. All of CSH's housing solutions integrate supportive housing. Supportive housing is a proven intervention that uses housing as a platform for services that create opportunities for recovery, personal growth and life-long success. CSH promotes and supports evidence-based programs and policies that are yielding positive outcomes for individuals and families, as well as, reducing costs for all levels of government.

CSH's Social Impact Investing Experience

CSH has been exploring the use of social impact investing in four key areas that directly contribute to the reduction of homeless populations. The first is to help states comply with the Supreme Court's *Olmstead v. L.C.* decision, requiring that people with disabilities are given the opportunity to live in integrated settings in a community. The second is to help communities target persons experiencing chronic homelessness who are also high utilizers of emergency health care, detox treatment and/or the justice system. The third is to help communities address the multi-faceted needs of families with high utilization of child welfare systems. The fourth is to meet the needs of young adults who are homeless, in foster care and/or in the juvenile justice system.

Creating Integrated Housing Solutions

The *Olmstead* decision first and foremost stands for the proposition that people with disabilities deserve to have a choice about where they live when they need an institutional level of care in order to have the option to live in the most integrated setting possible in the community. Social impact investment presents an opportunity to diversify and expand supportive housing, increasing access

for the people who need it most. It also leverages upfront private and philanthropic investment to finance interventions like supportive housing – with government paying only when agreed upon metrics and goals are met.

In general, the average cost of community-based care for the elderly, disabled and for people with intellectual disabilities is about one-third of the average cost of institutional care[i]. In its annual profile of long-term services and supports in 2012, the AARP showed that nationally persons with physical disabilities could receive services in the community for $10,957 versus $29,533 in a nursing facility. Persons with intellectual disabilities could be served in the community for $42,896 while institutional costs for the same group averaged $123,053 per person.[ii]

Generally, states lack the resources necessary to make upfront investment in supportive housing. This creates a timing issue for states that are trying to be proactive in creating more integrated housing. States cannot reduce investment in institutions until after they have created alternative opportunities in the community, but constrained budgets make it extremely difficult to secure the necessary upfront financing to create those housing options. Social impact investment can provide the upfront, non-public resources necessary to underwrite supportive housing in the community. After a substantial number of supportive housing opportunities integrated into the community are financed and made available, the state can reduce its investments in institutions and use those resources to pay for the supportive housing that was created.

CSH is working on a social impact bond in the state of Minnesota that will provide opportunities for individuals currently housed in Minnesota State-Operated Community Services (MSOCS) group homes to transition to the community in a manner that meets the support services needs of the individuals, provides them with suitable and affordable housing, increases their integration into the community and reduces the expenditure of state dollars in the provision of such housing and services. CSH is collaborating with the Minnesota Office of Management and Budget, Minnesota Department of Human Services and the Minnesota Housing Finance Agency.

Reducing Chronic Homelessness in Denver

In the City and County of Denver, an estimated 300 people are chronically homeless and/or high utilizers of public systems, and face substance abuse and/or mental health challenges. For just this cohort of chronically homeless adults, the Denver Crime Prevention and Control Commission determined that Denver spends roughly $11 million each year, including nights in shelters, run-ins with the police and visits to detox facilities. It's well documented that investments in permanent supportive housing – which offers both long-term housing and services for physical and mental health, substance abuse and other problems common in the chronically homeless population – can actually reduce long-term spending while improving outcomes for chronically homeless individuals. However, despite mounting evidence, local governments often have trouble securing the funds necessary to invest in supportive housing.

In June 2014, Denver Mayor Michael B. Hancock announced a new $8 million Social Innovation Bond (SIB) that will connect up to 300 chronically homeless individuals with supportive housing and intensive case management. The goal of the program is to provide participants with access to affordable housing linked to comprehensive services that can help address mental health, substance abuse and other challenges. The City has partnered with Enterprise, Social Impact Solutions and CSH on this initiative.

CSH is playing a key role in the initiative: identifying and vetting housing and service providers to partner with, securing the investments necessary, designing the evaluation and developing metrics, and negotiating with the City and County on success measures.

In addition to these two initiatives, CSH is actively pursuing social impact investment opportunities in Los Angeles, Massachusetts, Pennsylvania, and several other jurisdictions.

Other Pay for Success Initiatives

The Corporation for National and Community Service (CNCS) and the Social Innovation Fund (SIF) have selected CSH as one of eight 2014 Social Innovation Fund Pay for Success grantees. Supportive housing is consistently at the top of the list of effective interventions that can be brought to scale and fully realized through Pay for Success (PFS) financing. As the leader in the supportive housing industry, CSH has the experience to help the industry utilize PFS as a vehicle to expand supportive housing solutions. CSH will use the CNCS-SIF award to build on seed funding provided by the Rockefeller Foundation and Robert Wood Johnson Foundation, and provide expert advice and guidance to help up to 12 communities across the country implement robust Pay for Success financed supportive housing. CSH is pleased to have the Center for Health Care Strategies and Third Sector Capital Partners as its collaborating partners for this award.

Federal Support for Social Innovation Financing and Pay for Success

Much of CSH's recent work on connecting high utilizers of health care systems with housing and supportive services has been through the Social Innovation Fund (SIF) at the Corporation for National and Community Service (CNCS). Through this initiative, CSH has been able to develop programs to assist communities in addressing the needs of high-cost homeless populations by implementing cost-effective and innovation solutions. CSH has been working in five communities to improve coordination between housing and service providers, helping communities use data matching analytics to identify the most vulnerable households and ultimately reduce costs across various systems. CSH looks forward to the opportunity to build on this successful work through our recently awarded Pay for Success grant.

While the programs at CNCS are critical to help organizations like CSH work closely with communities to develop innovative programs, Social Innovation Bonds (SIBs) can help bring these programs to scale and achieve cost-savings at the local, state and federal level.

The two bills now pending before Congress (H.R. 4885/S.2691), the Social Innovation Bond Act, is an important first step in bringing the federal government to the table. Pay for Success and SIB financing models are helping cities and states realize where they can save money with the right collaboration and coordination. These programs are also yielding the federal government savings that are not being captured and ultimately reducing potential investment into these programs.

Further, the federal government often faces the "wrong pockets" problem, where one government entity is generating savings in another. This can happen laterally, where agencies at the same unit of government are investing while the other is reaping the benefits of cost-savings. It can also happen vertically, where a local agency is taking action that ultimately saves money to a higher unit of government. Bringing the federal government to the table could significantly expand the number of

SIB transactions by taking into account all potential cost-savings and increase the size of transactions.

CSH strongly supports the Social Innovation Bond Act introduced by Reps. Todd Young (R-IN-09) and John Delany (D-MD-06) and Sens. Michael Bennett (D-CO) and Orrin Hatch (R-UT). The bill is an important first step to increase the use of SIBs as a way to leverage private financing to address important public policy goals while achieving savings to the federal government.

We look forward to working with the sponsors and this committee to strengthen this piece of legislation. CSH has two recommendations to improve the bill and enable increased SIB investment in supportive housing initiatives.

- **Include place-based, housing-centered solutions as an eligible issue area for federal assistance.** The bill currently delineates several examples of possible programs that would be eligible for funding from the Treasury fund. We recommend allowing housing-focused initiatives to qualify for social impact bond financing to achieve important social benefits like reducing homelessness among populations recently released from incarceration, improving economic opportunities for homeless individuals and persons with disabilities or improving access to mainstream healthcare services for homeless populations to reduce reliance on emergency healthcare.

- **Provide flexibility to support SIB initiatives designed at the federal level**. As drafted, the bill only permits the Treasury Department to support SIBs that are designed at the state and local level. However, there are many opportunities for productive and cost-saving SIBs at the federal level. For example, the federal government could potentially construct a SIB contract between several agencies and private investors to fund an investment in a certain program (say, place-based services for dual-eligible seniors) that could improve health outcomes and reduce costs for Medicaid and Medicare. Such a program would not be eligible for funding through the proposed program, and no alternative funding source exists within the federal government.

CSH's work in the social innovating financing field continues to grow as we see it as an opportunity to help communities address their most vulnerable populations' most pressing needs. While SIB financing and Pay for Success programs have encouraged public and private sectors to work together to achieve important public policy goals, these initiatives alone cannot substitute for other state and federal investments. Instead, these initiatives can provide policymakers clear insight as to what works and changes that can improve the efficiency of many other programs.

Thank you for the opportunity to submit this statement for the record on this important topic. If you have any questions about this statement or about the work that CSH is doing in this field, do not hesitate to contact Hilary Swab Gawrilow (Hilary.gawrilow@csh.org), Director of Federal Policy or Andy McMahon (andy.mcmahon@csh.org), Managing Director of Government Affairs and Innovation.

[i] Houser, A., Fox-Grage, W., & Ujvari, K. (2012). Across the states: Profiles of long-term services and supports. Retrieved from http://www.aarp.org/content/dam/aarp/research/public_policy_institute/ltc/2012/across-the-states-2012-executive-summary-AARP-ppi-ltc.pdf

[ii] Houser, A., Fox-Grage, W., & Ujvari, K. (2012). Across the states: Profiles of long-term services and supports. Retrieved from http://www.aarp.org/content/dam/aarp/research/public_policy_institute/ltc/2012/across-the-states-2012-executive-summary-AARP-ppi-ltc.pdf

Douglas P. Koch, MAI, AICP, Statement

Letter for the Record for Ways and Means Human Resources Subcommittee Hearing on Social Impact Bonds and the Young/Delaney Social Impact Bond Act (H.R. 4885) at 2:00 pm on Tuesday, September 9, 2014

Dear Subcommittee Members of the Ways and Means Human Resources Subcommittee:
My name is Douglas P. Koch. I personally encourage Congress to pass the Social Impact Bond Act (H.R. 4885). My support is based on 35 years as a real estate finance and community development professional in which I have studied, observed and participated in the development and execution of America's very unique and robust evolving public and private partnership system. This system for developing and revitalizing communities and improving the lives of millions of American's has combined the best of public and private leadership and resources; successfully applying these resources to some of the nation's toughest challenges. This bill is simply another step in the evolution of that partnership. Additionally, my profession, and investor or development sponsors, has taken me to over 46 states, visiting over 1,000 communities/markets in order to study the feasibility of real estate, affordable housing and community development proposals. It is that experience that qualifies me in understanding the national applicability of this Bill.

From my professional and experiential perspective the passage of this Bill is needed for five reasons: (See Appendix for supporting references and additional clarification.)

1. **The bill will encourage more domestic social investment in the United States.** America lags behind in attracting social impact capital for domestic activities in terms of numbers of geographic locations of enterprises.
2. **The bill will encourage global social investment capital flows to the United States**. The social impact investment market is growing and government support in other nations encourages capital flows to those nations. The social impact market is growing and government support is vital to stimulate and support private efforts without burdening investment activity. Other nations, the United Kingdom and the Netherlands for example, have taken a direct role in fostering social impact investment. Not providing a leadership role now will only limit leveraging opportunities and push investors to those global locations where national governments support such efforts.
3. **The bill embraces and encourages impact measurement, which will help to encourage more uniformity in the nation, and is a necessary component of transparency and investment comparison.** Because leveraging private investment provides additional funding and would inherently encourage more objective performance evaluation, the encouragement of social impact bonds will create better and more uniform performance evaluations where social or public services are administered. This would be a spillover benefit to the administration of all government programs, regardless of the achievements of the Social Impact Bond initiative.
4. **The bill provides a partial alternative to continuing the longer term administration of government programs perceived as ineffective and inefficient; and a waste of taxpayer dollars.** Regardless of political persuasion, outlook on government expenditures or government tax policy or the specific identity of a particular government program, many social scientists, economists and political scientists (as well as many of we citizens) believe the effectiveness of government programs can be improved.
5. **The bill is crafted as cost effective and acts as a self-measured pilot incentive that provides sector applicable tools that would be embraced by units of government and private sector investors when applying for support**. I identified four sections of the bill that recognize leading best practices in impact investing applying principles of transparency, measurement and accountability as well as clear incentives for social impact investors to invest.

Douglas P. Koch, MAI, AICP advisoryaffiliates@gmail.com 617-512-6787
(Submitted as a private citizen) 63 Avalon Road, Waban, MA 02468

I provide support for my five points above in my attached Appendix. While this is hardly a scientifically supported research paper, my point of view represents the opinion of a 35 year veteran of affordable housing and community development underwriting and investing. In my sector of the economy and government assisted programs, we have worked hard to self-regulate, improve and leverage our investments of dollars and resources.

As an example, in my 35 years in the business, I have seen publicly supported efforts to improve affordable housing transformed. The Public Housing Program is a good example. By the mid-1970's it was identified as an isolated government program often ineffectively administered by fiefdoms of local politicians, coordinated by Federal Government officials who lacked imagination all for un-empowered, in many cases, impoverished Americans, often resulting in the housing itself becoming the cause of neighborhood deterioration as well as the locus of significant criminal activity.

However, through an array of bi-partisan government reforms from 1974 to 2014 and new programs that tap into an existing infrastructure of technical, investment and private sector resources we've seen Public Housing agencies open up to private investment, private property management and public/private partnerships that shift ownership and accountability away from government alone. Within the affordable housing business we continue to refine and critique, but the overall result in the last 40 years has been exposure to private investment, more self-regulation, the application of market and business-related principles in place of government rules and the transformation of many communities across the country. The application of similar market and business principles, the increase in accountability through impact measurement (both economic and social), the increase in transparency and the influx of private investment are all concepts that are embraced by social impact bonds and financing. I envision an analogous transformation of the social services and public services correctly executed through the application of properly encouraged , and supported, social impact bond and financing concepts.

Considering the general maturity of the public-private partnership concept as shown in housing and community development policy in the nation, the cooperation among different government units already engendered and the willingness of private capital to commit to public "programs" in this sector, isn't it logical to assume that a similar construct can be applied to social programs and issues?

I submit this letter as a private citizen with no specific client, organizational or programmatic affiliation supporting or associated with my effort. I do not submit this letter of support on behalf of anyone but myself. I simply believe, based on my experience and professional knowledge, that the Social Impact Bond Act (H.R. 4885) is good public policy and is framed in a manner to encourage initial national efforts without significant resource commitment or any risk to existing programs or other policy efforts.

Letter for the Record for Ways and Means Human Resources Subcommittee Hearing on Social Impact Bonds and the Young/Delaney Social Impact Bond Act (H.R. 4885) at 2:00 pm on Tuesday, September 9, 2014

Appendix

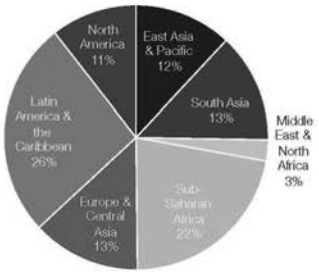
In my cover letter I stated that, from my professional and experiential perspective the Social Impact Bond Act (H.R. 4885) is needed for five reasons. This appendix provides documented support and additional clarification for these statements.

1. **The bill will encourage more domestic social investment in the United States.** America lags behind in attracting social impact capital for domestic activities in terms of numbers of geographic locations of enterprises.

   The graph below shows that 11% of Impact Enterprises are located in North America. There may be legitimate "global" reasons for such a low percentage, but certainly we can do better for ourselves.

Figure 11: Geographical Location of Impact Enterprises

Source: GIIN, Iris Data Brief (2013)



Sources and Commentary:

From the Margins to the Mainstream Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors A report by the World Economic Forum Investors Industries Prepared in collaboration with Deloitte Touche Tohmatsu, September 2013

Graph is on Page 15 and is taken from the Global Impact Investing Network (2013): IRIS Data Brief: Focus on Employment

2. **The bill will encourage global social investment capital flows to the United States**. The social impact investment market is growing and government support in other nations encourages capital flows to those nations. The social impact market is growing and government support is vital to stimulate and support private efforts without burdening investment activity. Other nations, the United Kingdom and the Netherlands for example, have taken a direct role in fostering social impact investment. Not providing a leadership role now will only limit leveraging opportunities and push investors to those global locations where national governments support such efforts.

   Sources and Commentary:
   As stated on page 13 of **Private Capital Public Good. How Smart Federal Policy Can Galvanize Impact Investing —and Why It's Urgent ,** June 2014 by the US National Advisory Board on Impact Investing. "All of this comes as impact investing shows signs of robust growth. A 2014 survey from J.P. Morgan and the Global Impact Investing Network (GIIN) of 125 major impact fund managers, foundations, and development finance institutions identified $46 billion in impact investments under management, with annual funding commitments estimated to increase by 19 percent in 2014. While this is significant, it remains a tiny fraction of the $210 trillion value of the world's equity market capitalization and outstanding bonds and loans. Projections of future market size vary but are tantalizing. Sir Ronald Cohen, a leading British venture capitalist and impact investor (and chair of the Global Social Impact Investment Taskforce) believes the market's potential to grow to be as large as "the $3 trillion of venture capital and private equity."

   (This study references **Spotlight on the Market: The Impact Investor Survey,** J.P. Morgan Global Social Finance and Global Impact Investing Network (GINN), May 2, 2014 " This report presents the findings of the fourth annual impact investor survey conducted by The Global Impact Investing Network (GIIN) and J.P. Morgan.")

   Sir Ronald Cohen, who is considered a father of venture capital and was an inaugural inductee into the Private Equity Hall of Fame, has also become a proponent of social impact investing. In his comments on the role of the United Kingdom in social impact investing he attributed nearly one quarter of the United Kingdom's expenditures in social service delivery as coming from non-government sources.

   In his speech on January 23, 2014 at the Mansion House, entitled "**Revolutionising Philanthropy: Impact Investment"** Sir Ronald Cohen stated "
   What about government? In the UK, what interaction does it currently have with social organisations, what benefits can it expect from impact investment? What role should it play? In the UK, in 2012, out of £250bn of social service delivery, government contracted out £61bn, £48bn to for-profit companies and £13bn to non-profit organisations. The nonprofit total has trebled over the previous nine years. The cost of direct social service delivery by government was £200bn. Of this, about half, say £100bn, might be simplistically viewed as "accessible" to impact investment. Simplistically adding the two would make a total accessible market of up to £150bn."
   http://www.ronaldcohen.org/sites/default/files/26/Sir%20Ronald%20Cohen%20Mansion%20House%20Speech%2023JAN14.pdf)

3. **The bill embraces and encourages impact measurement, which will help to encourage more uniformity in the nation, and is a necessary component of transparency and investment comparison.** Because leveraging private investment provides additional funding and would inherently encourage more objective performance evaluation, the encouragement of social impact bonds will create better and more uniform performance evaluations where social or public services are administered. This would be a spillover benefit to the administration of all government programs, regardless of the achievements of the Social Impact Bond initiative.

   Advocates for social impact investing are also supporters for impact measurement. Impact measurement extends to all "bottom lines", including economic, social and environmental. Impact measurement should be conducted or monitored and certified by independent organizations and can directly be used to encourage accountability and transparency; as well as a metric for distribution of returns on investment. The Social Impact Bond bill embraces impact measurement and, as a national effort, it will also promote uniformity and thus comparability in measuring the success of all social service and public service delivery-regardless of public or private funding.

   The previously mentioned, Impact Investor Survey (Spotlight on the Market: The Impact Investor Survey, J.P. Morgan Global Social Finance and Global Impact Investing Network (GINN), May 2, 2014) indicated on page 9 that:
   - "Ninety-eight percent of respondents feel that standardized impact metrics are at least "somewhat important" to the development of the industry.
   - The usage of metrics aligned with such standards is also significant: 80% of respondents reported using metrics that align with IRIS or external standards."

4. **The bill provides a partial alternative to continuing the longer term administration of government programs perceived as ineffective and inefficient; and a waste of taxpayer dollars.** Regardless of political persuasion, outlook on government expenditures or government tax policy or the specific identity of a particular government program, many social scientists, economists and political scientists (as well as many of we citizens) believe the effectiveness of government programs can be improved.

   Sources and Commentary:
   While many public policy analysts, social scientists and economists, as well as highly regarded think tanks have evaluated certain government programs, even Scientific American (See reference below.) published an article about failing public management. The interesting aspect of this article was its comprehensiveness and its focus on management, not politics. The point for promoting social impact bonds is: We should endeavor to explore all options that seem feasible on the surface, have some level of public and investor support and specifically have as a goal improving the delivery and impact of social and public services.

   The Failing U.S. Government--The Crisis of Public Management [Extended version] Scientific American, October 2009 Nothing less than an overhaul of the systems that implement federal policies will suffice Sep 21, 2009 , By Jeffrey D. Sachs **http://www.scientificamerican.com/article/the-failing-of-us-government/?print=true.**

5. **The bill is crafted as cost effective and acts as a self-measured pilot incentive that provides sector applicable tools that would be embraced by units of government and private sector investors when applying for support**. I identified four sections of the bill that recognize leading best practices in impact investing applying principles of transparency, measurement and accountability as well as clear incentives for social impact investors to invest.

   Commentary:
   The sections of the bill that seemed the most applicable relative to government involvement in social impact investment are:

   i. **Funding Projects That Work** *(Section 2053)* The bill specifies that only investments in interventions into public or social services that actually work will get funded.
   ii. **Helping States and Local Governments Implement Social Impact Bond Projects** *(Section 2054):* This part of the bill sets up a process for independent and closely scrutinized feasibility studies into proposed interventions relative to rewarding and monitoring the program. Feasibility studies prior to full scale investment will help weed out the frivolous and more experimental proposals and encourage up-front a connection among the various stages of investment execution: proposal, underwriting, implementation and evaluation/impact measurement.
   iii. **Evaluating Projects to Ensure Success** *(Section 2055)* The bill embraces the need for impact measurement. As mentioned in number "3" above, advocates for social impact investing are also supporters for impact measurement. Impact measurement extends to all "bottom lines", including economic, social and environmental. The bill encourages best practices as promoted by social impact investors, mainly that Impact measurement should be conducted or monitored and certified by independent organizations and can directly be used to encourage accountability and transparency; as well as a metric for distribution of returns on investment.
   iv. **Leveraging Local Investment** *(Section 2059) (CRA) The bill states that* "Treasury would permit a bank's investment in Social Impact Bond projects to be considered as part of the bank's requirement under the Community Reinvestment Act (CRA) to help meet the credit needs in their communities. " As a due diligence provider to bank investors in the Low Income Housing Tax Credit I am very aware of how strong an incentive this will be to encourage investment in any social impact investments authorized related to this bill. Most importantly, my same experience with these investors indicates that these investors would forego a significant portion of their investment return in exchange for CRA credit-thus further leveraging the ability of $1 related government support to produce multiples in private investment support.

Letter for the Record for Ways and Means Human Resources Subcommittee Hearing on Social Impact Bonds and the Young/Delaney Social Impact Bond Act (H.R. 4885) at 2:00 pm on Tuesday, September 9, 2014

Contact Information:

Name:	**Douglas P. Koch, MAI, AICP**
Organization:	**(None-submitted as a private citizen.)**
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Contact Email Address:	**advisoryaffiliates@gmail.com**
Title of Hearing:	**Subcommittee Hearing on Social Impact Bonds and the Young/Delaney Social Impact Bond Act (H.R. 4885) at 2:00 pm on Tuesday, September 9, 2014**

Thank you very much for the opportunity to submit this letter.

Enterprise Community Partners, Statement

Statement for the Record from Terri Ludwig
President and CEO, Enterprise Community Partners

House Committee on Ways and Means, Subcommittee on Human Resources
"Social Impact Bonds: Can They Help Government Achieve Better Results for Families in Need?"
September 23, 2014

Chairman Reichert, Ranking Member Doggett and members of the Subcommittee, thank you for the opportunity to submit this statement for the record regarding the recent hearing on Social Impact Bonds (SIBs).

I am President and CEO of Enterprise Community Partners, a national nonprofit that helps build opportunity for low- and moderate-income families, starting with a safe and affordable place to call home. We do this through public-private partnerships, where the private sector invests along with the public sector. Over the past 31 years, Enterprise has helped build or preserve more than 320,000 affordable homes across all 50 states, invested $16 billion into communities and touched millions of lives.

As federal, state and local resources for social programs continue to shrink, new solutions are needed to meet the various needs of low- and moderate-income communities. Whenever feasible, we must leverage the capital and innovation of the private sector and ensure that any available resources are put to the best possible use. Enterprise sees SIBs as a promising tool for promoting public-private partnerships, scaling innovative solutions to pressing social problems and achieving better social, economic and health outcomes—all while ensuring better use of federal dollars.

As the witnesses discussed during the hearing, under a typical SIB contract, private investors provide upfront capital to fund a particular program. Those investors are paid back by the government with a financial return only if predefined social outcomes are achieved. Often the financial return to investors comes from the money saved through a reduction in government spending. If the program falls short, the investors would not recoup their upfront investment and incur losses.

The contract is overseen by at least one intermediary—such as Enterprise—which is responsible for negotiating the terms of the deal, identifying service providers, raising capital from private investors and disbursing payments. In addition, all parties agree to have an independent evaluator track the program's outcomes through a rigorous analysis.

Enterprise's Experience with SIBs and Other Pay-for-Success Models

Enterprise is currently involved in the development of two SIB contracts: one to reduce chronic homelessness in Denver, and one to reduce the number of days homeless children stay in foster care in Cuyahoga County, Ohio. We are also working closely with the U.S. Department of Housing and Urban Development (HUD) and our national partners to develop a similar "pay-for-success" pilot to finance cost-saving energy and water system improvements in government-assisted apartment buildings. Below is a brief summary of each initiative.

Reducing chronic homelessness in Denver

In the City and County of Denver, an estimated 300 people are chronically homeless and face substance abuse and/or mental health challenges. For just this cohort of chronically homeless adults, the Denver Crime Prevention and Control Commission determined that Denver spends roughly $11 million each year, including nights in shelters, run-ins with the police and visits to detox facilities. It's well documented that

investments in permanent supportive housing – which offers both long-term housing and services for physical and mental health, substance abuse and other problems common in the chronically homeless population – can actually reduce long-term spending while improving outcomes for chronically homeless individuals. However, despite mounting evidence, local governments often have trouble securing the funds necessary to invest in supportive housing.

At the Clinton Global Initiative meeting in June, Denver Mayor Michael B. Hancock announced a new $8 million SIB that will connect up to 300 chronically homeless individuals with supportive housing and intensive case management. The program, which is one of the first city-led SIB initiatives in the country, aims to address the underlying causes of homelessness, including mental illness and substance abuse, while also reducing costs in the city's criminal justice and emergency health systems. The city will partner with Enterprise, Social Impact Solutions and the Corporation for Supportive Housing (CSH) in this initiative. To date, Enterprise has played a leading role in conducting feasibility, structuring and transaction services and identifying the housing strategy that will most effectively serve the target population, working closely with CSH, Social Impact Solutions, the city and local investors.

Reducing the number of days homeless children stay in foster care in Cuyahoga County, Ohio

In communities across the country, out-of-home placement (commonly referred to as "foster care") is a last-resort option for at-risk and vulnerable children. Children who are able to stay safely and stably with their family often have better health, education, economic and other outcomes, leading to an improved quality of life and reduced government spending (from the health care costs to time spent in the criminal justice system). However, in many jurisdictions, a child in out of home placement cannot be reunited with his or her family until the adult has a safe and stable home. As a result, children of homeless parents are often unable to be reunited with the parent for longer periods of time, when a better (and less costly) solution would be to help the entire family find an affordable home connected to the services they need.

The County Executive's office in Cuyahoga County, Ohio, is looking to the SIB model as a possible solution to this problem. In July, the Cuyahoga County Council approved the country's first county-level SIB, intended to reduce the number of days children spend in out of home placement by connecting families to a safe and affordable home and necessary services. The proposed pilot would raise $5 million in private funds to help FrontLine, a Cleveland-based social service provider, connect 135 mothers who have experienced homelessness and have at least one child in out of home placement to housing, crisis and trauma services. Enterprise is now working with FrontLine, the county's Division of Children and Family Services, the Cuyahoga Metropolitan Housing Authority, Case Western Reserve's Center on Urban Poverty and Community Development, the George Gund Foundation and Third Sector Capital Partners to work through the details of the program and transaction. If enacted, Enterprise will serve as the program's intermediary, providing day-to-day oversight of the program and ongoing financial management services.

Promoting energy efficiency through "pay-for-success"

HUD currently spends about $7 billion each year on energy bills in government-supported buildings. Through certain renovations to improve energy and water efficiency, HUD could potentially cut utility costs by an estimated 20-25 percent (before accounting for upfront costs), while meaningfully reducing instances of asthma and other respiratory and cardiovascular problems for residents. However, in today's fiscal environment, it is highly unlikely that HUD will receive the federal funds necessary to make these cost-saving improvements on their own.

In July, a bipartisan group of members of Congress led by Reps. Dennis Ross (R-FL-15) and Jim Himes (D-CT-4) introduced a bill that would permit HUD to launch a "pay-for-success" demonstration to help

pay for cost-saving energy and water efficiency upgrades. Under the proposed program, intermediaries would raise private capital and work with energy service companies and others to make appropriate and economically justifiable upgrades. HUD would only pay investors back if predetermined savings were achieved over a certain period. Enterprise has worked with HUD, Stewards of Affordable Housing for the Future (SAHF) and the Low Income Investment Fund (LIIF) to help design and advance this important legislation. If enacted, we look forward to working with HUD and our partners to help implement the demonstration to maximize both the financial savings to taxpayers and the broader benefits to residents and the environment.

The Need for Increased Federal Support to SIBs

So far, SIBs have been conducted at the local or state level taking into account only expected savings in state or local spending. In all of these cases, however, meaningful federal savings will also be achieved. For example, the Denver SIB mentioned above will yield significant federal savings in health care, specifically in reduced Medicaid spending. If the SIB accounted for those long-term federal savings, additional private sector financing could be secured.

Federal participation will also help solve of the "wrong pocket" problem, where one government entity sees savings from actions of another entity. This can happen "laterally" among local agencies or "vertically," where spending at the local level yields savings at the federal level. This is especially likely when a local program targets a population receiving significant federal support, such as elderly adults, people with disabilities or veterans. By bringing the federal government to the table and ensuring that all savings at every level of government are accounted for, we could significantly expand the number and type of SIB deals that are financially feasible.

The Social Impact Bond Act

Enterprise strongly supports the Social Impact Bond Act (H.R. 4885) introduced in June by Reps. Todd Young (R-IN-9) and John Delaney (D-MD-6), as well as the companion bill introduced in the Senate by Sens. Michael Bennet (D-CO) and Orrin Hatch (R-UT). The bill could meaningfully increase the use of SIBs, attract additional private financing, yield significant savings in federal spending and improve social, economic, and health outcomes for low- and moderate-income families.

The proposed program would give the federal government a seat at the negotiating table, allowing state and local practitioners to quantify and capture federal savings as part of a SIB's financial model. In addition, the proposed $300 million fund within the Department of Treasury would help mitigate the "wrong pocket" problem by providing a single source of federal support to state and local SIBs.

We look forward to working with Rep. Young, Rep. Delaney and the members of the Subcommittee to further strengthen the proposal. Specifically, we have two immediate recommendations for improving the bill:

- **Include place-based, housing-focused solutions as an example of an issue area eligible for federal assistance.** As drafted, the bill lays out more than a dozen examples of programs that are eligible for funding through the Treasury fund, ranging from improving high school graduation rates to reducing teen and unplanned pregnancies. We recommend including another example for place-based, housing-focused initiatives, such as programs that prevent stays in homeless shelters or services that improve economic, health and other outcomes for the chronically homeless, low-income seniors or other vulnerable populations.

- **Provide flexibility to support SIB initiatives designed at the federal level**. As drafted, the bill only permits the Treasury Department to support SIBs that are designed at the state and local level. However, there are many opportunities for productive and cost-saving SIBs at the federal level. For example, the federal government could potentially construct a SIB contract between several agencies and private investors to fund an investment in a certain program (say, place-based services for dual-eligible seniors) that could improve health outcomes and reduce costs for Medicaid and Medicare. Such a program would not be eligible for funding through the proposed program, and no alternative funding source exists within the federal government.

The Path Forward

SIBs are a relatively new but effective tool for directing private capital toward public projects. They are part of the growing field of "impact investing," which blends financial returns with intentional and measurable social outcomes.

Last year, Enterprise helped launch the Accelerating Impact Investing Initiative (AI3), the first hub for policy topics related to impact investing in the U.S. Since then, Enterprise and our AI3 partners—Pacific Community Ventures and Harvard's Initiative for Responsible Investment—have helped spark a national conversation about the federal government's role in expanding and improving the marketplace for impact investments, including SIBs.

In the coming months, Enterprise and our AI3 partners will work to identify high-priority policy recommendations, build cross-sector coalitions around those recommendations and engage key policymakers to usher in meaningful reforms. We are still developing the specifics of AI3's policy platform, but one pillar will be the expansion of SIBs and other "pay-for-success" initiatives at the local, state and federal level. We look forward to engaging members of this Subcommittee as that work progresses.

Now more than ever, we need the public and private sectors to work together to tackle the most pressing social and economic problems facing low-income communities. SIBs and other "pay-for-success" models are definitely not a panacea, but they are an important tool to have at our disposal.

Again, thank you for the opportunity to comment on this important topic. If you have any questions about the above comments, please contact me at tludwig@enterprisecommunity.org; Diane Yentel, Enterprise's Vice President for Public Policy and Government Affairs, at dyentel@enterprisecommunity.org; or Victoria Shire, Enterprise's Vice President for Vulnerable Populations, at vshire@enterprisecommunity.org.

Green & Healthy Homes Initiative, Statement

Testimony for the Subcommittee on Human Resources

Ways and Means Committee

Social Impact Bonds: Can They Help Government Achieve Better Results for Families in Need?

Submitted by:

Ruth Ann Norton, President and CEO
Green & Healthy Homes Initiative

The Green & Healthy Homes Initiative (GHHI) has prepared this statement to illustrate the opportunity for social impact bonds and pay for performance to create healthy, safe and energy efficient housing with significant impact on healthcare, energy, and education costs.

Impact of Unhealthy Housing

Generations of chronic disinvestment in low income communities have left nearly 9 million families trapped in unhealthy and energy inefficient housing. Unhealthy housing is the source of 535,000 cases of childhood lead poisoning, 750,000 asthma related emergency room visits, 10,000 carbon monoxide poisonings and 13 million preventable home related injuries every year. Among children, 70% of lead poisonings and 40% of asthma episodes are avoidable through home interventions. Childhood environmental diseases cost society over $111 billion annually ($56B asthma, $43B lead poisoning, $3B childhood cancer, $9B for neurobehavioral disorders). Home injuries are the second leading cause of death for children under five years and lead to more than 10 million emergency room visits per year; this results in $222 billion in medical costs annually, with falls in the home accounting for $81 billion. Additionally, low income households typically spend 14% of their total income on energy costs versus 3.5% for other households. Asthma is the leading medical cause of school absences, resulting in 14 million absences a year and 10 million missed work days for parents.

Funding Outlook to Address Unhealthy Housing

Federal funds to address unhealthy and inefficient housing are decreasing. Federal funding in FY14 directly targeting lead poisoning and health and safety deficiencies was $110 million, with the U.S. Department of Housing and Urban Development's Office of Lead Hazard Control and Healthy Homes with $10 million directed toward the Healthy Homes Initiative. This represents a decrease from FY10 with funding levels at $140 million with $25 million directed to the Healthy Homes Initiative. With this funding decrease, HUD has not been able to issue any direct Healthy Homes Demonstration or Production grants to local communities since FY11, and has only provided funds for Healthy Homes Technical Studies and supplemental funds to lead hazard control grantees to address health and safety conditions in homes such as radon, carbon monoxide, mold, pests, and asthma triggers. This puts the entire Healthy Homes sector in

serious jeopardy, with the potential to have a negative effect on millions of families, and contribute billions in costs to local, state, and federal budgets, with minor ($10 million nationwide) current federal investment. As seen above, housing conditions impact a wide variety of health and associated societal conditions, which broadens the opportunity to identify economic value from improving housing conditions. Broad health conditions, energy utilization, educational outcomes, and neighborhood stabilization are all affected by home deficiencies.

This sector is a prime target for Social Impact Bond / Pay for Success structures, and GHHI has advanced this work in Maryland and across the country. There is ample evidence of the effectiveness and return on investment of Healthy Homes practices in addressing issues such as lead poisoning and asthma. An NIH study published in Environmental Health Perspectives showed a return of $17-221 for every dollar invested in lead paint hazard control.[i] U.S. Department of Health and Human Services' Guide to Community Preventive Services reviewed published cost-benefit studies on home-based, multi-trigger, multicomponent environmental interventions and found the studies show a return of $5.3 to $14 for each dollar invested.[ii] Healthy Homes services for high cost medical utilizers within the Medicaid population could yield very high returns on investment, with just 5% of Medicaid beneficiaries accounting for 54% of total Medicaid expenditures and 1% of Medicaid beneficiaries accounting for 25% of total Medicaid expenditures. Healthy Home interventions for asthma show a very quick return, with savings from avoided medical expenditures surpassing the cost of home interventions in one to two years. A quick return is very attractive to investors and reduces the risk to all parties exploring pay for success.

Green & Healthy Homes Initiative (GHHI) Background

GHHI is a 501c3 nonprofit organization. Our role in creating healthy, safe and energy efficient homes began in 1986 in Baltimore, Maryland with the founding of Parents Against Lead (PAL). PAL set out to "break the link between unhealthy housing and unhealthy children." In 1993 PAL became the Coalition to End Childhood Lead Poisoning which now does business as GHHI and provides direct service programs that have served over 25,000 Baltimore families. GHHI works to eradicate deficiencies from occupied homes to drive better outcomes for children, seniors, families and communities. Our work in response to the interrelated tragedies of deteriorating housing conditions and childhood lead poisoning launched one of the most successful public health and housing campaigns in the United States—resulting in a 98% decrease in the incidence of childhood lead poisoning in Maryland between 1993 and 2013 (from 14,546 to 364). GHHI has advised 36 jurisdictions around the country on lead poisoning prevention and healthy homes policies and practices. Drawing upon its deep experience in the lead hazard control, healthy housing, and weatherization fields, the organization launched a national initiative in 2008, with the aim of transforming the country's fractured and siloed approach to

the delivery of energy and health-based housing interventions. We employ 45 healthy homes professionals, headquartered in Baltimore and operating in four regional offices (Providence, RI; Jackson, MS; Los Angeles, CA; Washington, DC).

GHHI's National Impact

GHHI's proven model optimizes public and private investments and produces:

- Measurable health (e.g., asthma, lead poisoning) improvements to children and families,
- Directs public cost savings (reduced emergency room visits and hospital stays),
- Reduced energy consumption and lower monthly utility bills,
- The ability for public systems to invest in home improvement in a more efficient way,
- Higher paying "green collar" jobs in communities, and
- Reduced absenteeism in schools and at jobs.

There are currently 18 GHHI-designated cities and we will grow to 60 sites by 2017. Corporate entities and philanthropies have committed over $69 million in investments towards GHHI efforts. The model is showing dramatic impact on the health, social, and economic well-being of families, as well as improving how local governments provide services. The initial sites have generated impressive positive outcomes through the production of the first 5,000 "GHHI Certified" units in their communities. For two years running, a HUD Secretary's Award for Public-Philanthropic Partnerships has been won by organizations for their GHHI work: the Community Foundation of Greater Buffalo in 2012 and the Rhode Island Foundation in 2013. GHHI was highlighted in the 2013 Federal Healthy Homes Work Group report, "Advancing Healthy Housing: A Strategy For Action" under the goal to "Explore Ways to Leverage Funding across Federal and Non-Federal Programs."

GHHI's Pay for Success in Baltimore

Substandard housing conditions have a profound effect on respiratory health, particularly on pediatric asthma, and cause preventable utilization of emergency medical care services. GHHI addresses the underlying housing conditions and removes environmental health hazards responsible for preventable asthma episodes that send beneficiaries back to the hospital. The integrated delivery of environmental health services, health education and home improvement, is necessary to address asthma at the primary source of asthma trigger exposure, the home. GHHI has developed a comprehensive assessment tool to identify home deficiencies in patients referred from hospitals, asthma clinics, and health and housing departments in Baltimore. Upon assessment, a single scope of work is written for the home incorporating all needed

interventions and service providers. Depending on the needs, a home may receive: health, safety, and energy conservation education for the residents; weatherization, ventilation, and insulation; energy efficient windows; gutter/downspout replacement; sealing to prevent water intrusion; integrated pest management services; plumbing repairs; air filtration unit; roofing repair; flooring replacement; lead-based paint stabilization; furnace replacement; allergen and asthma trigger reduction; and other additional home improvements.

Evaluation of GHHI's services has shown dramatic impact on patients with asthma. GHHI has seen a 60% reduction in asthma-related hospitalizations following a GHHI home intervention, with a 25% reduction in emergency room visits. A study has also shown a 67% reduction in home-based asthma triggers. Families served through GHHI have seen a $405 average annual reduction in home energy bills. The home improvements have significantly improved school attendance, with a 62% increase in asthmatic children not missing any days due to asthma, as well as work attendance, with an 88% increase in parents not missing any days of work due to their child's asthma.

Johns Hopkins Healthcare Systems (Hopkins), one of the health entities that refers patients to GHHI, worked with the organization to do cost benefit analysis in 2013 to further illustrate the impact of GHHI's work. Taking cost information from Maryland's Department of Health and Mental Hygiene (DHMH) and Priority Partners, Hopkins' Medicaid Managed Care Organization, GHHI and Johns Hopkins enlisted Milliman Inc., a leading health actuarial firm to conduct analysis. In 2010, the average cost per asthma ED visit was $820 in Baltimore, and the average cost per inpatient admission (hospitalization) was $7506. From the avoided medical costs of emergency room visits, hospitalizations, and professional specialty care services following GHHI services, Milliman projected $5,782 per patient in the 3 years following the intervention.

This return on investment attracted the Calvert Foundation (Calvert), a 501(c)3 impact investment firm and registered Community Development Financial Institution (CDFI) that connects individual, retail investors with organizations working to improve health, develop affordable housing, create jobs and protect the environment. GHHI, in partnership with Calvert and Hopkins have made great progress in 2014 in advancing an asthma-focused Pay For Success project in Baltimore, Maryland. Calvert is serving as the investor and intends to invest $10 million into the project. GHHI is serving as the service provider and intends to deliver its proven, evidence-based housing intervention and resident education services that reduce asthma triggers in the home. Hopkins, serving as the private payor, intends to accrue savings (and pay back the investor) through reduced emergency room visits, hospitalizations and professional services for their patients. GHHI will provide services for 1800 Hopkins asthma patients, which is projected to produce $15 million in savings for Hopkins from avoided medical costs. Over three years (600 patients each year) the project will target Medicaid high-cost super-utilizers,

pediatric patients who have been hospitalized or have been to the emergency room for asthma. Hopkins will provide back to Calvert an agreed upon return if the project is a success. The project is scheduled to begin in early 2015. While the model is unique in that a private entity, Johns Hopkins Healthcare, is acting as the payor/saver, because of the potential impact on the state Medicaid budget, health and energy expenditures, and education through reduced absenteeism, GHHI and its partners will work with DHMH and other state and local government agencies to track additional metrics beyond the avoided costs to Hopkins throughout the project to pave the way for additional pay for success deals or budgetary decisions.

Taking GHHI's Pay for Success Model to Scale

GHHI is already in 18 cities around the country (Atlanta, Baltimore, Buffalo, Chicago, Cleveland, Denver, Detroit, Dubuque, Flint, Jackson, Lansing, Lewiston, New Haven, Oakland, Philadelphia, Providence, San Antonio, and Salt Lake) and is speaking with a few dozen other communities who are interested in becoming part of the initiative over the next couple years. All of these localities have a GHHI service provider entity that could be incorporated in a pay for success structure similar to what has been put together in Baltimore. Healthcare entities such as Intermountain Healthcare in Salt Lake, St. Christopher's Hospital in Philadelphia, and Memorial Hospital of Rhode Island have already been engaged in discussions with GHHI on mapping out these structures and their role as a private sector saver. Medicaid offices in Michigan, Mississippi have already been in discussions around acting as a government saver. And GHHI has already begun to engage investors such as Calvert and Third Sector Capital Partners who could act in that investor role. GHHI and Calvert have a pending application to the Corporation for National Community Service's Social Investment Fund Pay for Success program to provide technical assistance and assess feasibility of setting up pay for success deals similar to Baltimore at five other locations across the country.

Transformative Impact to Federal and Local Budgets and Services

Asthma is a chronic condition with a high burden in terms of cost and societal impact. Over 25 million Americans suffer from asthma, including 7 million children (1 in 11). Asthma costs nationwide are $56 billion annually. According to the Robert Wood Johnson Foundation, 40% of all incidents of asthma are attributable to home-based environmental health hazards. In 2010, asthma accounted for 3.1 million emergency department visits. From 1997 to 2008, the inflation adjusted costs of asthma medications for children quadrupled. With asthma being one of the health conditions where prevalence is still increasing, a dramatic change in the national approach is needed. Home-based public health prevention by a multidisciplinary team is the most cost-effective approach to address the problem at its source. As a social determinant of health, housing deficiencies present proximal conditions that have been strongly associated with allergen sensitization and asthma exacerbation.[iii] Interventions conducted in the home

environment present a unique opportunity to prevent asthma exacerbations which are commonly triggered by exposure to allergens and irritants within the home.[iv] The US Department of Health and Human Services' Community Guidelines recommend community-based interventions that include assessment of the home environment, changing the indoor home environment to reduce asthma triggers, and health education about the home environment.[v]

GHHI's holistic approach is broader than just addressing asthma. Mitigating all environmental health hazards identified in the home has the added benefit of improving other health outcomes, such as lead poisoning, chronic obstructive pulmonary disease symptoms, reducing senior trip and fall injuries, and reducing home accidents. The costs associated with home deficiencies are borne by a variety of local, state, and federal entities, which gives flexibility when identifying savers to construct pay for success models. Health, education and energy budgets in particular are impacted by housing conditions and these agencies can serve as leaders in future, similar investment opportunities.

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Institute for Child Success, Statement

Introduction

The Institute for Child Success is excited by the progress of discussions in Congress surrounding Pay for Success financing models (often called Social Impact Bonds). We thank Representatives Young and Delaney for their leadership in proposing H.R. 4885, and also thank Chairman Reichert for holding a Subcommittee hearing to discuss this topic on September 9, 2014.

The Institute for Child Success respectfully submits the following written comments to the hearing record for your consideration. In these comments, we begin with an overview of our perspective on the benefits of Pay for Success financing, and how these financing models can be particularly advantageous for programs serving our youngest children. We then discuss the substantial benefits of federal involvement, the reasons that legislation is necessary for meaningful federal engagement, and the ways in which H.R. 4885 responds to that need.

Like with any new and exciting innovations, we should also resist the temptation to treat Pay for Success financing as a cure for all ills. Indeed, many have voiced significant concerns – including one of the witnesses at the Subcommittee's hearing on September 9, 2014. We too want to acknowledge the limitations of social impact bonds, and address how 4885 appropriately handles those limitations; we discuss several of these issues at the end of these comments.

Benefits of Pay for Success Financing (or Social Impact Bonds)

Pay for Success financing is a model that can help scale-up effective interventions to improve outcomes for young children, while saving governments money. The fundamental structure is well known to many, so we will only provide a very brief overview here. At its most basic level PFS involves four components:

- A program or intervention that has been tested, and has demonstrated that it produces desired outcomes and that its benefits exceed its costs;
- Investors that provide the upfront capital required to bring the intervention up to a larger scale;
- A government entity that agrees to repay the investor if the agreed-upon outcomes are realized; and
- An independent evaluator that determines whether the intervention accomplishes the pre-determined outcomes and, therefore, the government should make payments to the investor.

Because of the novelty and complexity of these arrangements, a third-party intermediary has also been involved in many of the Pay for Success contracts entered into to-date.

Pay for Success financing provides a number of benefits over traditional government mechanisms for selecting and scaling up interventions, including:

- It allows governments to shift resources towards effective prevention and early intervention;
- It draws on expertise and energy from outside investors (either commercial or philanthropic), who ultimately bear much of the financial risk if a program is ultimately not effective at scale;
- A rigorous cost and savings analysis is necessary to even consider a Pay for Success arrangement, increasing the ability of the government to select interventions wisely; and
- Outcomes measurement is a centerpiece at every step, allowing the necessary tracking processes to be "baked in" to an intervention from the very beginning.

Taken together, these benefits allow for the

- Extension of public-private partnerships;
- Increased efficiency and accountability of social program performance;
- Guarantee that governments only pay for outcomes rather than for services provided.

Pay for Success and Effective Early Childhood Interventions

As we discussed in our January brief on this topic, Pay for Success is particularly well suited to help scale effective early childhood interventions.[1] Many interventions exist today with long-term outcomes that are both independently compelling and result in significant cost savings to governmental entities. Those outcomes include:

- Fewer preterm births,
- Fewer teen pregnancies,
- Fewer closely spaced second births and fewer preterm second births,
- Fewer injury-related visits to the emergency room,
- Reductions in child maltreatment,
- Children more ready for kindergarten,
- Less youth crime,
- Reduced incarceration rates,
- Higher achievement in school or careers,
- More economically independent mothers, and
- Increased lifetime earnings.

Yet despite wide agreement that we should develop and implement these effective early childhood interventions broadly, it is very challenging to do so. Many governmental agencies are working to

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[1] Institute for Child Success, *Pay for Success Financing for Early Childhood Programs: A Path Forward*, 2014, available at: http://www.instituteforchildsuccess.org/mydocuments/pay_for_success_financing_for_early_childhood_program2.pdf.

implement effective early childhood interventions, but those efforts are far from full-scale. Two barriers stand out:

1) **Resources are tied up in responding to problems, leaving little room for prevention.** Governments are busy putting out fires – that is, responding to problems after they happen – and after more cost-effective responses are no longer an option. Given the fiscal pressure faced by all governmental entities, government is rarely able to devote sufficient up-front resources to developing or implementing effective methods to prevent problems in the first place, even if those approaches would save money in the long run. For instance, the Institute of Medicine has documented the costs of failing to focus on prevention, finding that many mental, emotional, and behavioral disorders in young people are preventable, but that prevention remains underfunded.[2]
2) **The costs of wide-scale implementation are immediate, but the payback takes time.** Although many programs will deliver both social and financial returns, those benefits take time. Governments often find it difficult to afford investments with delayed returns.

Pay for Success can help address both of those barriers. Governments are able to implement tested interventions without immediately burdening the budget, since the model allows government to wait until the relevant outcomes are met before payments must be made. If those interventions are ultimately effective at scale, then the resulting cost-savings can be used to repay the investors' principal and any premium that is agreed to at the outset. Moreover, if the interventions do not produce the agreed-upon outcomes, and the government doesn't realize the cost savings as a result, then the investors (who bear the financial risk) and are not repaid.

It is important to note: all parties benefit from having investors who are mindful of the outcomes and want the program to succeed. The interventions that are currently best suited to Pay for Success financing have already been rigorously tested at a smaller scale. Much of the risk, then, relates to the difficulties inherent in scaling a program to a significantly larger size and serving different populations, which are challenges with which some investors have significant expertise. In other words, while the investors bear the risk of failure, they can also help reduce that risk in some cases.

Why Does the Federal Government Need to Get Involved

One of the questions that often arises in discussions about Pay for Success is this: Why is it important for the federal government to get involved? The simple answer is that many effective interventions

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[2] National Research Council (US) and Institute of Medicine (US) Committee on the Prevention of Mental Disorders and Substance Abuse Among Children, Youth, and Young Adults, *Preventing Mental, Emotional, and Behavioral Disorders Among Young People: Progress and Possibilities*, 2009, available at http://www.ncbi.nlm.nih.gov/books/NBK32775/

produce positive results and save money at both the federal and state or local levels and, for many of those, the federal government has a significant interest.

For example, some pre-natal interventions result in the reduced pre-term births, which also reduces risks of traumatic and costly medical complications.[3] For infants from low-income families, those improved birth outcomes also result in significant savings to Medicaid. For a state that only pays for 30% of Medicaid services, however, most of the long-term savings (70%) will be passed on to the federal government. Congress should, therefore, position federal programs to foster and leverage those outcomes. If it does so, both states and the federal government will benefit, as more cost-effective interventions will be viable for Pay for Success financing.

In addition, the federal attention and funding will incentivize jurisdictions around the country to increase accountability for outcomes in government programs. Identifying the most effective programs and tracking their outcomes requires capacity and effort. This legislation will support and incentivize jurisdictions to build that capacity. The result will be more cost-effective government programs and better outcomes for our communities and our country.

Why Do We Need Legislative Action to Encourage Pay for Success

The typical appropriations process presents two significant barriers that prevent agencies from engaging in meaningful Pay for Success deals, both of which are addressed by H.R. 4885. First, Federal appropriations typically have to be "obligated" by September 30 of any given fiscal year. What we've learned over the last few years is that many of these deals take more than one year to develop to the contract-signing phase. Knowing that the money may vanish after months of diligent work, but before a deal is finalized, is a substantial hurdle.

Second, federally appropriated dollars typically have to be disbursed within 5-years after the fiscal year in which they are appropriated (under 31 U.S.C 1552(a)). Many Pay for Success contracts are best suited to something a little longer than a 5-year window, if only because most programs take a couple of years to reach scale, and long-term outcomes may take several years to be fully measured after that. As an example, the first Social Impact bond out of the United Kingdom was a 6-year contract.

Both of those barriers require Congressional action, but the fix is relatively simple: provide appropriations that are expressly available for a longer amount of time. H.R. 4885 does so. However, there is a larger challenge the federal government will face as it engages in Pay for Success deals, and that is a challenge of human capital. Federal entities are generally not experienced in this field, and we

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[3] Institute of Medicine, *Preterm Births: Causes, Complications, and Prevention,* 2006, available at: http://www.iom.edu/~/media/Files/Report%20Files/2006/Preterm-Birth-Causes-Consequences-and-Prevention/Preterm%20Birth%202006%20Report%20Brief.pdf.

need to develop that expertise in a deliberate fashion. H.R. 4885 creates an interagency working group that is led by Treasury and includes officials from several agencies. Through that mechanism, we can begin building expertise throughout the federal systems, allowing us to operate more sustainably in this field going forward.

What are the Limitations and Challenges of Pay for Success

As with any exciting policy innovation, it is easy to lose sight of the limitations and challenges. There are some problems for which Pay for Success is simply not a solution. For example, it does not provide a sound model for funding programs, or for encouraging better evaluation of programs, that are already operating at scale. It also is poorly suited to fund untested innovations (though, a robust Pay for Success mechanism might encourage novel innovations to look to robust evaluation early).

Similarly, Pay for Success might not make the most sense in those rare circumstances where success is nearly guaranteed, because the model does involve premium payments in exchange for investors bearing the risk of failure. In a case where there is very little risk, then the investment would be less beneficial from a financial perspective. Even in that scenario, however, Pay for Success financing may provide governments the fiscal relief they need to help shift resources from remediation towards prevention by enabling them to pay at the end of the project rather than at the beginning.

Moreover, Pay for Success financing deals are just difficult to put together, from a technical perspective. We expect those technical challenges to diminish as the number of deals increase, which H.R. 4885 would facilitate. At the moment, though, Pay for Success deals are only appropriate for projects that are large-scale enough that the benefits exceed the transaction costs.

What are some of the technical challenges of Pay for Success financing?

- **Identifying rigorously tested interventions:** We have to find and develop interventions with rigorous evidence of outcomes. There are many interesting interventions out there with great confidence in, but little proof of, their results. So the first hurdle is identifying the rigorously tested programs, and then also encouraging promising programs to develop the kind of evidence that investors and governments need. H.R. 4885 wisely emphasizes the importance of feasibility studies to address both of these issues.

- **Identifying governmental entities:** One difficulty here flows from the fact that cost savings, especially from early childhood interventions, often cross governmental domains - from Medicaid to juvenile justice to education. It is sometimes difficult to find a single agency that reaps enough of the benefits to afford the full costs of a successful program. H.R. 4885 addresses this issue in two ways. First, the interagency working group is a single entity that can look at benefits across the federal government and, second, the legislation is created to support state and municipal deals that have a federal component.

- **Identifying appropriate outcome metrics:** We have to be very cautious to identify outcome metrics with which the service providers, the investors, and the government are all comfortable. This is one of the most challenging elements, particularly with respect to concerns over creating perverse incentives. PFS financing should also avoid the danger that providers will "game the system." It can avoid that risk by evaluating outcomes compared to a control group or a matched comparison group. If the evaluation is well designed, any changes in how outcomes are measured will affect both the program group and the control group equally, and thus will not translate into misleading results. This challenge is also why building expertise and collaboration within the federal contracting system – as H.R. 4885 proposes – is critical to long-term success.

- **Building the system to measure success:** As mentioned above, a centerpiece of Pay for Success financing is rigorous and ongoing outcome measurement, which is challenging for even the best-resourced programs. Pay for Success, however, builds that evaluation into the model from beginning to end, and in such a way that it cannot get lost in the shuffle – investors only invest, and only get a return, if successes are measured and verified by an independent evaluator. H.R. 4885 supports that model by expressly requiring that the evaluation mechanisms be identified at the beginning.

Given these difficulties, why is so much progress happening anyway?

- **Investors are asking for it:** We frequently hear from bank executives that their high-net-worth clients increasingly seek investments that are in line with their values. More and more, the industry is focusing on generating both direct financial returns *and* positive social outcomes.

- **Governments are looking for more cost-effective strategies to achieve public goals:** Governments – at all levels – spend a tremendous amount of resources responding to crisis situations and providing remediation services. Those governments would normally have to sacrifice some of those critical services to invest resources in early interventions. Pay for Success allows governments breathing room to pay for interventions out of the long-term savings they produce. This is also a phenomenon that makes Early Childhood an ideal sector for Pay for Success financing, given the magnitude of long-term savings produced. Moreover, Pay for Success financing helps governments move in a direction they are increasingly interested in: toward analyzing benefits and costs of specific strategies and choosing the ones that produce the best value for taxpayers.

Conclusion

Pay for Success Financing is a very promising model for scaling effective early childhood interventions while saving governments money in the long term. The Institute for Child Success is very encouraged by the attention this financing model has received by our elected officials at the federal level, and we

are even more encouraged by the introduction of legislation like H.R. 4885. This financing model is challenging, especially for the federal government, but has tremendous potential for improving our collective fiscal position while directly improving social outcomes. We look forward to continued work with the Subcommittee and Congress on this issue in the weeks and months to come. Thank you for the consideration of these comments.

About the Institute for Child Success

The Institute for Child Success is a research and policy organization that leads public and private partnerships to align and improve resources for the success of young children in South Carolina and beyond. A partnership of the Greenville Health System's Children's Hospital and the United Way of Greenville County, ICS supports those focused on early childhood development, healthcare, and education—all to coordinate, enhance, and improve those efforts for the maximum effect in the lives of young people. For more information: www.instituteforchildsuccess.org.

ReadyNation, Statement

Statement of ReadyNation
On
HR 4885: The Social Impact Bond Act

To the

Human Resources Subcommittee
Ways and Means Committee
U.S. House of Representatives

Robert H. Dugger, Ph.D. and Philip A. Peterson, FSA[1]
Co-Chairs, Board of Advisors
Sara Watson, Ph.D., National Director

ReadyNation

September 15, 2014

Introduction

Mr. Chairman and members of the Human Resources Subcommittee, we are honored to provide the views of ReadyNation on the Young/Delaney Social Impact Bond Act (H.R. 4885). We applaud Congressman Young and his colleagues for their foresight and leadership in introducing legislation that provides resources for the development of "pay for success" (PFS) social impact finance projects sponsored by state and local governments that reduce taxpayer burdens and increase program effectiveness.

Encouraging partnerships between private, philanthropic and public sectors to improve social programs through mechanisms such as this legislation will increase collaboration among stakeholders to solve social problems while ensuring that taxpayer money is spent wisely only on interventions that can demonstrate promised outcomes.

ReadyNation

ReadyNation is the preeminent business membership organization whose purpose is to ensure the U.S. has the most productive competitive workforce in the world and enable our nation to regain self-generated sustainable economic growth – through maximizing the life-success of young children. With more than 1,100 business leader members and a 32-member CEO council, ReadyNation has been a pioneer in developing and helping establish PFS projects to scale up early childhood interventions that reduce taxpayer burdens and produce positive returns for young children and their families, for taxpayers, and for county, state and the federal governments.

[1] The authors may be contacted at: rhdugger@hanprov.com; phil.peterson100@gmail.com and swatson@readynation.org

ReadyNation respectfully submits the following comments concerning the legislation in the hope that the final legislation will encompass all worthy social impact finance project areas, create more accountability, and grant the flexibility needed to deliver the greatest value in promised outcomes. Our comments are limited to applications of PFS social impact finance to early childhood interventions.

We believe that it is crucial to maintain the current Federal funding structures for early childhood, including early childhood education and home visiting programs, and that this legislation should in no way imply that social impact finance projects should alter or supplant such funding for existing proven programs. PFS social impact finance is a very promising technique to further scaling up successful and evidence-based programs, but it cannot and should not replace funding for programs that have been shown to deliver quality outcomes for children and families.

We applaud the work Congressmen Young and Delaney have done to draft and introduce HR 4885, the Social Impact Bond Act. It is a milestone in the development of social impact finance in the United States. This bill establishes certain key standards for PFS projects that will serve to strengthen and speed the expansion of cost-effective social and health interventions.

Summary

Our comments focus on the substance of Sections 2051 and 2052 of the legislation. Where provisions in these two sections are repeated in Sections 2054 and 2055, our comments also apply to those sections.

Fundamentally, there are appropriations and participation risks posed by the inability of government entities to make success payments under social impact finance contracts, and the inability of government agencies, that cannot under current law or regulation enter into a contract, to share a portion of its remediation cost avoidance, respectively. We believe the legislation addresses both of these potential risks with respect to the federal government. We make the following requests for changes or additions to the legislation:

- We ask the authors of HR 4885 to consider including in the evidence standard sections of the bill the presence of committed private investors, whether individuals, businesses, or philanthropies, as overriding evidence of prospective project success.
- **Section 2051(4) --** We suggest the insertion of "state and" before "local governments" as another entity implementing effective social interventions.
- **Section 2052(b) –** We suggest amending clause (10) to read:
  (10) Improving prenatal, neo-natal and early child heath, reducing instances of child abuse and neglect, increasing workforce preparedness through increasing school-readiness, reducing special education assignments or grade retentions, or increasing elementary and secondary classroom productivity.

  and, deleting clause (7) and renumbering accordingly.
- **Section 2052(c)(3) --** We suggest clause (3) be amended to read:

(3) Rigorous evidence demonstrating that the intervention can be expected to produce the desired outcomes, including the involvement of private individual, corporate, institutional and philanthropic investors.

- **Section 2052(c)(6) --** We suggest amending the provision to read:
  (6) Projected total costs to conduct the project, including development and operations costs to deliver the intervention and operate the intermediary.
- **Section 2052(c)(21)** and **Section 2055(b) –** We suggest amending the section to strike "…including, where available, well implemented randomized control trials…"
- **Section 2052(c)(3) and 2054(a)(3) --** We suggest adding the following language in separate clauses in both sections, which read: "Demonstration that quality data specific to the intervention will be available to support the outcome goals of the project, including sources for such data and the process by which such data will be procured and analyzed."

HR 4885 Addresses Crucial Obstacles to Development of Early Childhood PFS Finance Projects

Many factors are converging to make early childhood PFS projects feasible

Accumulating research findings indicating significant short-term reductions in government health and education remediation costs, increased data management, rising business interest in workforce competitiveness, and increasing awareness of skilled labor shortages are combining to propel strong private and public support for results-based financing. At the same time, there is growing focus on investing in children prenatal to age five.[1] Legislation strengthening state investment in young children is being considered and enacted on an unprecedented scale – by Republicans and Democrats - addressing a wide range of dimensions including governance, systems, funding, reading and literacy, program access and expansion, parent involvement, teacher preparation and certification, school readiness assessment, quality rating and improvement systems, home visiting, prekindergarten, and state committees and councils.[2]

High economic returns, particularly on high quality prenatal to age five programs provided to at-risk children, have been long understood. For over a decade early child development specialists talked about "invest in kids bonds", but the seeming long-term nature of the financial payoffs in the form of lower teen pregnancy, crime, and drug use, made financing unfeasible. More recent research has shown strong near-term returns in the form of lower newborn intensive care use following prenatal counseling and lower special education assignments following prekindergarten.[3] These together with widening data availability and contract development, is propelling active consideration of home visiting and prekindergarten PFS projects in over twenty states.

PFS projects demonstrate the high early childhood investment returns to business and elected leaders

PFS projects anchored by private funds are inherently local and small in financial terms, and will likely continue to be. PFS projects require longitudinal data on outcomes from specific providers of interventions, not just general data on types of interventions. For this reason, for example, where data indicate that a specific preschool program reduces special education assignments in a

given school district, and private lenders and philanthropies are willing to put their money at risk to finance expansion of the program, we should not be surprised if elected officials in that region across a broad spectrum support the undertaking. Anyone doubting this impact needs to take a look at what is happening in Salt Lake County. There, broad bipartisan support emerged for the Granite School's three and four year-old preschool curriculum. This support was buttressed by loans extended after careful due diligence by Goldman Sachs and J. B. Pritzker and willingness of the strongly business-oriented United Way of Salt Lake to be the recipient of the loans and to act as the central organizer of the project.[4]

HR 4885 financing could remove appropriations and participation risks

The bare-bones central features of PFS projects are (1) an "intermediary" enters into a contract with a "provider" of goods and services that can enable a government agency to avoid certain costs, usually remediation costs of some kind; and (2) the intermediary simultaneously enters into a contract, which is based on current law and appropriated funds, with a government agency that says the agency will pay a portion of the "cost avoidance" as a "success payment" to the intermediary.

Appropriations Risk

Appropriations risk is the risk that a state or federal government agency is unable to make the success payments specified in the contract because the legislature did not appropriate adequate funds as expected. In specific terms for example, it is the risk that a school district does not remit the contractually defined share of special education costs avoided by providing at-risk children high quality prekindergarten because its state legislature or county government decides to allocate the cost avoidance savings elsewhere and fails to appropriate funds to make the success payments.

Participation Risk

Federal participation risk is the risk that a federal agency is a clear beneficiary of a PFS project, and its participation would enable the project to be financially feasible, but the agency cannot under current law or regulation enter into a contract to share a portion of its remediation cost avoidance. In specific terms for example, it is the risk that the U.S. Department of Health and Human Services under current law cannot enter into an agreement to remit a portion of Medicaid cost avoidance resulting from high-quality prenatal counseling for at-risk mothers and subsequent lower newborn hospital intensive care costs. Because Medicaid is such a large component of low-income health care finance, without federal participation, it is difficult to structure a feasible PFS prenatal counseling or home visiting program. In such cases, feasibility depends on significantly increasing the state and philanthropic contribution portions of the project, which may not be possible. South Carolina's Nurse Family Partnership PFS project may face this challenge if the Department of Health and Human Services is unable to change its practices through law or regulation to remit a portion of the Medicaid cost avoidance that results from scaling up Nurse Family Partnership services.[5] In general, participation risk arises when the federal government is a beneficiary of a PFS project but chooses not to participate and pay its

fair share. In this circumstance, the general government "free-rides" on the initiative of business and philanthropy and diminishes the ability of the PFS project to expand worthwhile services.

HR 4558 Addresses Appropriations Risk

If the Treasury Secretary as provided for by HR 4885 were authorized to guarantee payment of state or federal agency contractually determined success payments, appropriation risk would be removed. While it is a fact that the number of instances of government agencies not making contractually agreed upon payments is actually quite small, it is also a fact that a legislature through its budgeting process (or its failure) could delay or prevent an agency from making contractual success payments. This possibility is a constraint on PFS development. States are taking steps to attempt to reduce appropriations risk, but its existence continues to be a challenge.[6]

HR 4885 Addresses Participation Risk

Similarly, if the Treasury Secretary as provided for by HR 4885 were authorized to make success payments on behalf of federal agencies that are benefitting from cost avoidance but are unable under current law to enter into PFS contracts, federal free-rider participation risk would be eliminated. Medicaid cost avoidance sharing was mentioned earlier.

General Comments on HR 4885

Private Sector Involvement

As the witnesses who appeared before the subcommittee on September 9, 2014 explained, PFS finance has many advantages. It draws on the judgment and initiative of private sector investors in combination with philanthropic institutions and local and state governments. It is based on statistical evidence of sufficient quality to persuade private investors to put their own money at risk.

The key idea is that in a PFS arrangement, private sector evidence evaluation and the willingness to take risk and the ability to initiate action, can be harnessed to develop and pay for needed intervention expansions using near-term, monetizable cost avoidance savings with clear performance assessment.

In addition to near-term cost avoidance, PFS finance provides a framework for states to capture the longer-term benefits of outcome improvements such as fewer neglect and child abuse prosecutions, improved school-readiness, higher 3rd and 4th grade reading and math scores, higher graduation rates and improved job-readiness. While these longer-term benefits are not immediately monetizable, their effects on budget and tax burdens are concrete and very important.

Together, these near-term cost avoidance and longer-term outcome improvements are the reasons why partnerships of private investors, philanthropies, and governments are an important answer to finding what early childhood interventions work and scaling them up for full effect.

Need for Recognition of Private Sector Commitment in Evidence of Prospective Success

Though the central idea of PFS social impact finance is to harness private sector capabilities and capacities to take action, there appears to be no mention of this in HR 4885, nor do these capabilities and capacities appear to be incorporated into the standards for receiving funds under the bill. As a consequence, enactment of HR 4885 may fail to fully achieve its goals.

We ask the authors of HR 4885 to consider including in the evidence standard sections of the bill the presence of committed private investors, whether individuals, businesses, or philanthropies, as essential evidence of prospective project success.

Technical Comments

Section 2051(4) – In several states, high quality social program interventions are sponsored, regulated and funded directly by the state. We suggest the insertion of "state and" before "local governments" as another entity implementing effective social interventions. As amended, the provision would read:

> (4) To facilitate the creation of public-private partnerships that bundle philanthropic and other private resources with existing public spending to scale up effective social interventions already being implemented by private organizations, non-profits, charitable organizations, and state and local governments across the country.

Section 2052(b) – Many kinds of early childhood interventions result in federal cost avoidance budgetary savings. Prenatal counseling, for example, improves birth outcomes and infant health and reduces child abuse and neglect, which result in state and federal healthcare and child welfare cost avoidance savings. Prekindergarten improves school readiness and reduces special education assignment rates and grade retention, which results in public school special-ed cost avoidance savings. We suggest deleting clause (7), amending clause (10) to read as below, and renumbering accordingly:

> (10) Improving prenatal, neo-natal and early child heath, reducing instances of child abuse and neglect, increasing workforce preparedness through increasing school-readiness, reducing special education assignments or grade retentions, or increasing elementary and secondary classroom productivity.

Section 2052(c)(3) – In most cases, the reason a PFS finance approach is being used to expand or scale-up an effective intervention is because private sector philanthropically-oriented investors see an opportunity to pay for scaling-up using the proceeds from near-term government cost avoidance savings. These investors have evaluated the evidence and are prepared to put their money at risk to prove the intervention works and will improve life outcomes, and reduce tax payer burdens in the future.

In a PFS framework, a critical piece of evidence that the project will succeed is the presence of private people and entities willing to put their money at risk. In fact, because in PFS

arrangements, governments make no payments if expected and contracted-for cost avoidance does not occur, governments face no potential loss. Accordingly, it is curious that this bill requires "rigorous evidence" that the intervention will succeed. This evidence is what the investors need. Most likely they already have it, and evaluated it thoroughly in making their decision to invest in the project.

There certainly can be no objection to requiring submission of the feasibility studies the investors used in their decision making, but it must be kept foremost in mind that if there are no investors willing to put their money at risk, there will be no discussion of a PFS project. Hence, the most important evidence of project success, and the most important standard for Federal government funding of the sort contemplated by HR 4885, is the presence and commitment of private sector for-profit or non-profit investors.

We suggest clause (3) be amended to read:

> (3) Rigorous evidence demonstrating that the intervention can be expected to produce the desired outcomes, including the involvement of private individual, corporate, institutional and philanthropic investors.

Section 2052(c)(6) – Depending on the financing sources for the project that follow the feasibility study, it may not be possible to specify with certainty the costs to the government entity for conducting the project. We suggest amending the provision to read:

> (6) Projected total costs to conduct the project, including development and operations costs to deliver the intervention and operate the intermediary.

Section 2052(c)(21) and **Section 2055(b)** – Randomized control trials will not be possible in many interventions due to the covariates and project conditions. It may be that quasi-experimental methodologies may be necessary. Moreover, because the federal government is not at risk in PFS arrangements -- neither the Treasury Department will make outcome success payments nor will federal agencies from their own funds – without confirmation by a qualified independent evaluation that cost avoidance savings occurred, we do not believe that the research design methodology used by the evaluator should be prescribed in the legislation. This is the responsibility of the agency head and the intermediary.

For these reasons we suggest amending the section to strike "…including, where available, well implemented randomized control trials…"

Section 2052(c)(3) and 2054(a)(3) – Social impact finance projects approved under the legislation will not be able to demonstrate the requisite "Rigorous evidence demonstrating that the intervention can be expected to produce the desired outcomes," without quality data to support the evidence that such intervention yields the desired outcomes. The availability and procurement of such data can be challenging, especially for proposed interventions where data collection efforts are nascent, where data exist but are difficult to access due to the absence of definitive data sources (i.e. clearinghouses, institutions), and where data exist but may not be

specific to the covariate criteria (e.g. geography, demographics, confounding factors) in the specific intervention being proposed.

For these reasons we suggest that a feasibility study include access to quality data. We suggest adding the following language in separate clauses in both sections, which read: "Demonstration that quality data specific to the intervention will be available to support the outcome goals of the project, including sources for such data and the process by which such data will be procured and analyzed."

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Endnotes

[1] See for example:

- "Social Impact Bonds: A Guide for State and Local Governments." Social Impact Bond Technical Assistance Lab (SIB Lab), Harvard Kennedy School. June 2013. http://hkssiblab.files.wordpress.com/2013/07/social-impact-bonds-a-guide-for-state-and-local-governments.pdf
- David Erickson, ed. "Pay for Success Financing." Community Development Investment Review 9 (1). Federal Reserve Bank of San Francisco. April 2013. http://www.frbsf.org/community-development/publications/community-development-investment-review/2013/april/pay-for-success-financing/

[2] "2013 Legislative Session" Education Commission of the Sates, November 2013. http://www.ecs.org/clearinghouse/01/10/04/11004.pdf

3 See for example:

- "Early Childhood 'Pay-For-Success' Social Impact Finance: A PKSE Bond Example to Increase School Readiness and Reduce Special Education Costs." Report of the Kauffman Foundation/ReadyNation Working Group. April 2012. http://www.readynation.org/uploads/db_files/Kauffman-ReadyNation%20PKSE%20Report%2012041922.pdf and
- "Early Childhood Pay for Success Social Impact Finance: Organizational Steps, Memorandum of Understanding and Contract Outlines." Report of the ReadyNation Working Group on contracts in Early Childhood Social Impact Finance, ReadyNation Working Paper, June 10, 2013. http://www.readynation.org/uploads/db_files/RN%20PFS%20Contracts%20Working%20Group%20Report%20130610.pdf
- Janis A. Dubno, Robert H. Dugger, and Michelle R. Smith. "Financing Human Capital Development for Economically Disadvantaged Children: Applying Pay for Success Social Impact Finance to Early Child Development." ReadyNation Working Paper, June 10, 2013. http://www.readynation.org/uploads/db_files/RN%20PFS%20Finance%20Dubno%20Dugger%20Smith%20Paper%20130610.pdfhttp://www.readynation.org/uploads/db_files/RN%20PFS%20Finance%20Dubno%20Dugger%20Smith%20Paper%20130610.pdf

[4] See "FACT SHEET: The Utah High Quality Preschool Program America's First "Results-based Financing" for Early Childhood Education". https://hceconomics.uchicago.edu/sites/default/files/pdf/events/Salt%20Lake%20City%20PFS%20Fact%20Sheet%20%20%28FINAL%2010-28-13%29.pdf

[5] See "Using Pay for Success Financing to Improve Outcomes for South Carolina's Children: Results of a Feasibility Study". Institute for Child Success, September 2013 http://payforsuccess.org/sites/default/files/using_pay_for_success_financing_to_improve_outcomes_for_south_carolinas_children_-_results_of_a_feasibility_study.pdf

[6] The Massachusetts statute establishes the Social Innovation Financing Trust Fund for the purpose of funding PFS contracts. The statute requires the Secretary of Administration to request an appropriation for each fiscal year that the contract is in effect, in an amount equal to the expected success payments that the Commonwealth would be obligated to pay in the future based upon the service provided during that fiscal year and the payable success payments for achieved contractual performance targets. http://www.malegislature.gov/Content/Documents/Budget/FY2013/ConferenceReport-H4219.pdf

Results for America, Statement

STATEMENT OF MICHELE JOLIN,
FOUNDER AND MANAGING PARTNER, RESULTS FOR AMERICA

TO THE SUBCOMMITTEE ON HUMAN RESOURCES
COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES

"SOCIAL IMPACT BONDS: CAN THEY HELP GOVERNMENT ACHIEVE BETTER RESULTS FOR FAMILIES IN NEED?"

September 9, 2014

Chairman Reichert and Ranking Member Doggett:

Thank you for the opportunity to provide a statement on behalf of Results for America in support of H.R. 4885, the Social Impact Bond Act. This bipartisan legislation would help make the federal government more effective and efficient by spurring government at all levels to take a Moneyball approach to social services. Social Impact Bonds are already leveraging private investment, hard data, and rigorous evaluation to improve public programs for young people, their families, and communities. This bill will help drive even more Federal taxpayer dollars toward practices, policies, and programs that work and are achieving results.

ABOUT RESULTS FOR AMERICA

Results for America, an initiative of America Achieves, is committed to improving outcomes for young people, their families, and communities by shifting public resources toward evidence-based, results-driven solutions. The Social Impact Bond financing model -- also known as Pay for Success or Pay for Performance -- is an important example of how government can drive taxpayer dollars in this results-oriented way.

SOCIAL IMPACT BONDS

Under the Social Impact Bond (SIB) model, a local, state, or federal government determines a desired outcome from a publicly-funded program, private investors fund a service provider that has demonstrated they can achieve that outcome, and the government reimburses the investors if the outcome is met. SIBs allow governments to innovate and make smart, results-driven spending choices while limiting taxpayer risk.

Social Impact Bonds are gaining momentum all across the United States. New York City, New York State, Massachusetts, and Utah are currently operating Social Impact Bond models. The Harvard John F. Kennedy School of Government's Social Impact Bond Technical Assistance Lab (SIB Lab) is also working with Republican and Democratic mayors and governors from the following cities and states to determine how they can use SIBs to improve outcomes for their residents: Chicago, Colorado, Connecticut, Denver, Illinois, Massachusetts, Michigan, New York, Ohio, and South Carolina.

FEDERAL SUPPORT FOR SOCIAL IMPACT BONDS

The Obama Administration began implementing Pay for Success efforts in FY 2012 using existing authorities. In September 2012, the U.S. Department of Justice awarded a Pay for Success implementation grant to Cuyahoga County, Ohio and a planning grant to Lowell, Massachusetts under the Second Chance Act as well as a contract to develop a blueprint for governments to use Pay for Success to reduce recidivism. In September 2013, the U.S. Department of Labor awarded almost $24 million to the States of Massachusetts and New York to increase employment and reduce recidivism among formerly incarcerated individuals through the Workforce Innovation Fund. In the FY 2014 omnibus appropriations act, Congress also authorized the U.S. Department of Justice to use up to $7.5 million of Second Chance Act funds to support Pay for Success, including $5 million to implement projects using the permanent supportive housing model, and the Corporation for National and Community Service to use up to $14 million for Pay for Success awards under the Social Innovation Fund. The Administration's FY 2015 budget request also includes up to $82 million to support Pay for Success initiatives across eight programs in the U.S. Departments of Education, Justice, and Labor and the Corporation for National and Community Service. As in FY 2014, the request also includes a $300 million Pay for Success Incentive Fund at the U.S. Department of the Treasury to help empower governments at all levels to implement Pay for Success efforts.

THE SOCIAL IMPACT BOND ACT (H.R. 4885)

Results for America strongly supports H.R. 4885, the Social Impact Bond Act. On July 16, 2014, we hosted a Capitol Hill briefing on how Social Impact Bonds and H.R. 4885 can help government at all levels invest taxpayer dollars more effectively and efficiently. We were honored that U.S. Representatives Young and Delaney attended this event to discuss H.R. 4885 and that the following non-profit leaders were also able to discuss how they are currently using Social Impact Bonds to invest in what works: Tom Jenkins, President and CEO, Nurse Family

Partnership; George Overholser, CEO & Co-Founder, Third Sector Capital Partners; and Sam Schaeffer, CEO & Executive Director, Center for Employment Opportunities.

Results for America also strongly supports S. 2691, the Pay for Performance Act, introduced by U.S. Senators Michael Bennet and Orrin Hatch on July 30, 2014, as a companion bill to H.R 4885.

CONCLUSION

The urgency and complexity of our nation's challenges require us to disrupt the status quo, move beyond traditional approaches, and explore and experiment with promising new methods including Social Impact Bonds. America continues to face enormous social and economic shifts, budget constraints at all levels of government, significant demographic changes, and an increasingly globally competitive workforce. Therefore, we must continue to focus on ways to greatly improve outcomes for young people, their families, and communities. Social Impact Bonds are a step in the right direction to help achieve those outcomes.

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