

# **Pay for Success: The Cutting-Edge Public/Private Partnership that is Funding Nonprofits and Luring Investors**

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# Definitions

Pay for Success



**Performance-based contracting** within the social sector where government/end payer pays only if results are achieved

Social Impact Finance\*

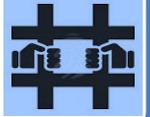


**Financing that bridges timing gap** between government/end payer payments and upfront capital needed to run PFS programs.

\* Social Impact Bonds (SIBs) are a type of SIF

# Areas of PFS Applications

- Community-based interventions that prevent institutionalization, e.g.
  - **Foster Care, Juvenile Justice, and Mental Health**



- Health-based interventions that result in Medicaid savings, e.g.
  - **Home Visitation**



- Education-based interventions that promote grade progression, retention, and school completion, e.g.
  - **Universal Pre-school**



- Home-based interventions to address homelessness, e.g.
  - **Supportive Housing**



- Workforce-based interventions, e.g.
  - **Job Readiness**



*The success of any PFS project is contingent upon the ability of a selected service provider and intervention to meet pre-determined outcome targets.*

# Key Players in a PFS Project

## Government

- **Initiates contract and identifies intermediary and/or provider(s)**
- **End payer for successful outcomes**

## Intermediary

- **Negotiates deal construction, identifies service providers and raises capital**
- **May also be contract holder and service project manager**

## Service Provider(s)

- **Delivers services**
- **Receives complete cost coverage; may receive performance payments**

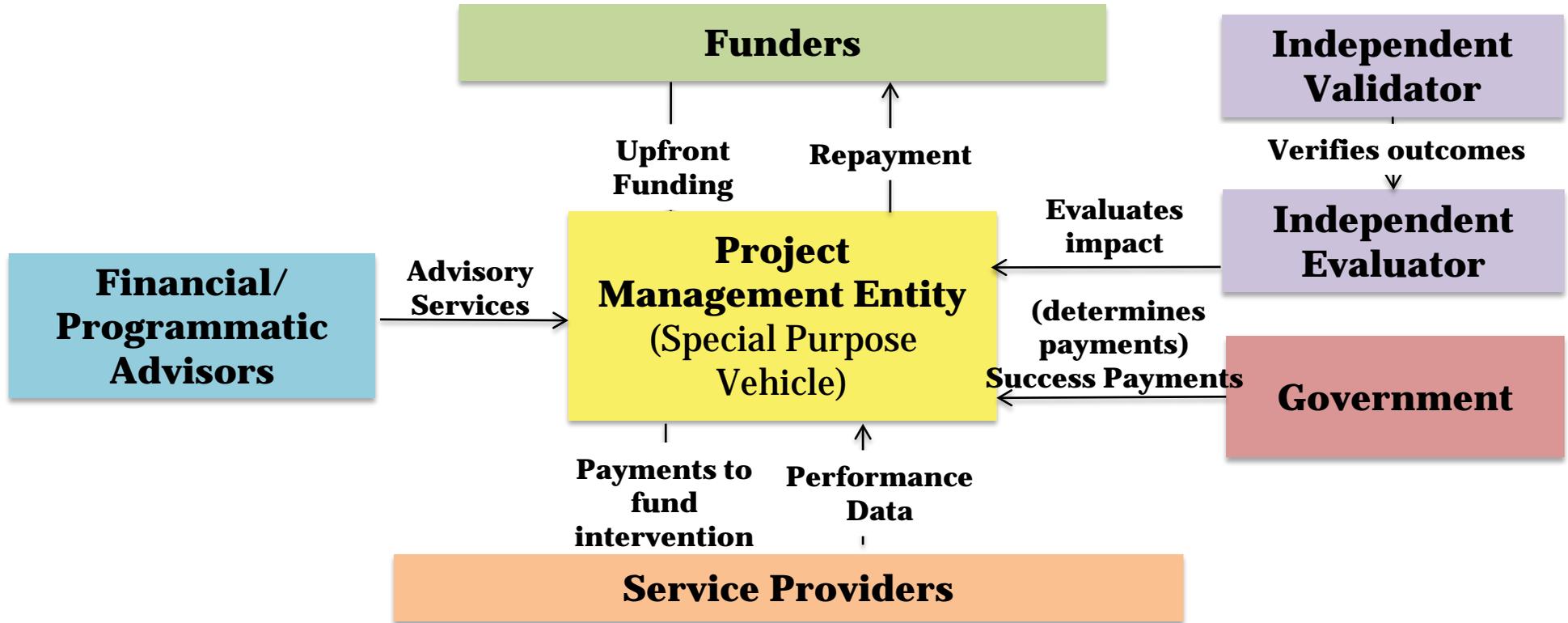
## Investors

- **Provide working capital to intermediary/providers**
- **May lose capital if project unsuccessful or be re-paid with government success payments**

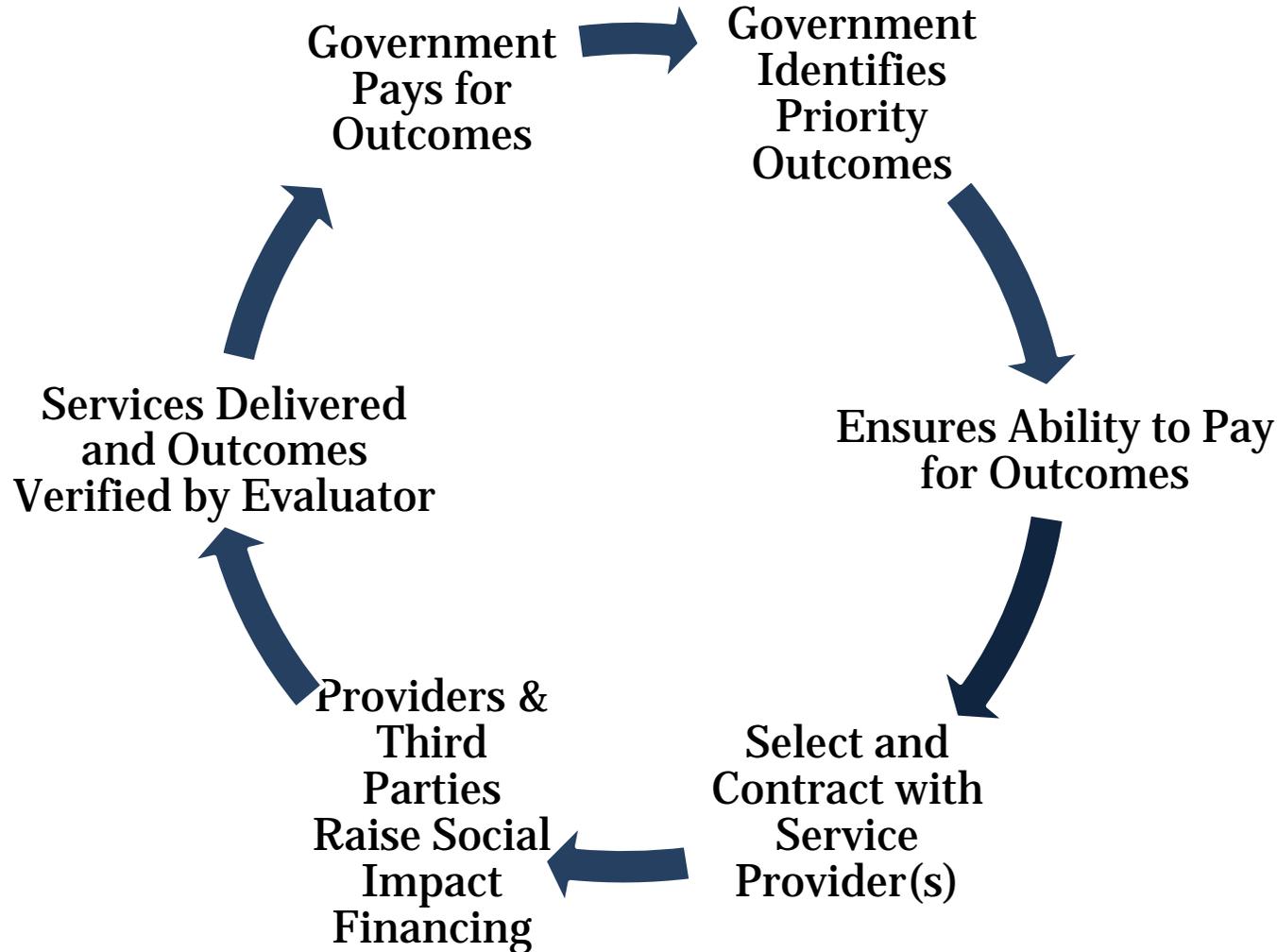
## Evaluator

- **Supports rigorous evaluation design; measures progress towards outcomes based on contract requirements**

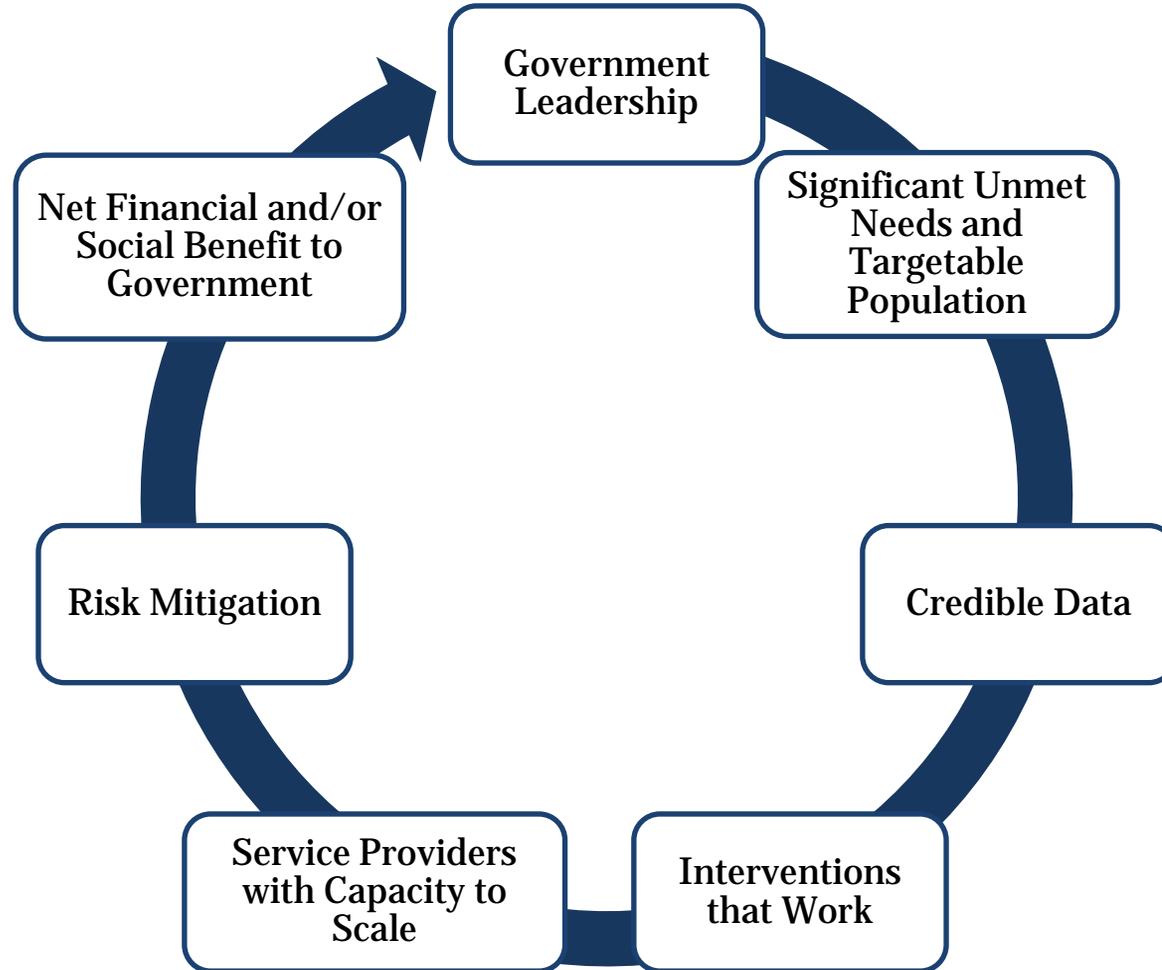
# Structure of a PFS Project



# PFS Process Flow



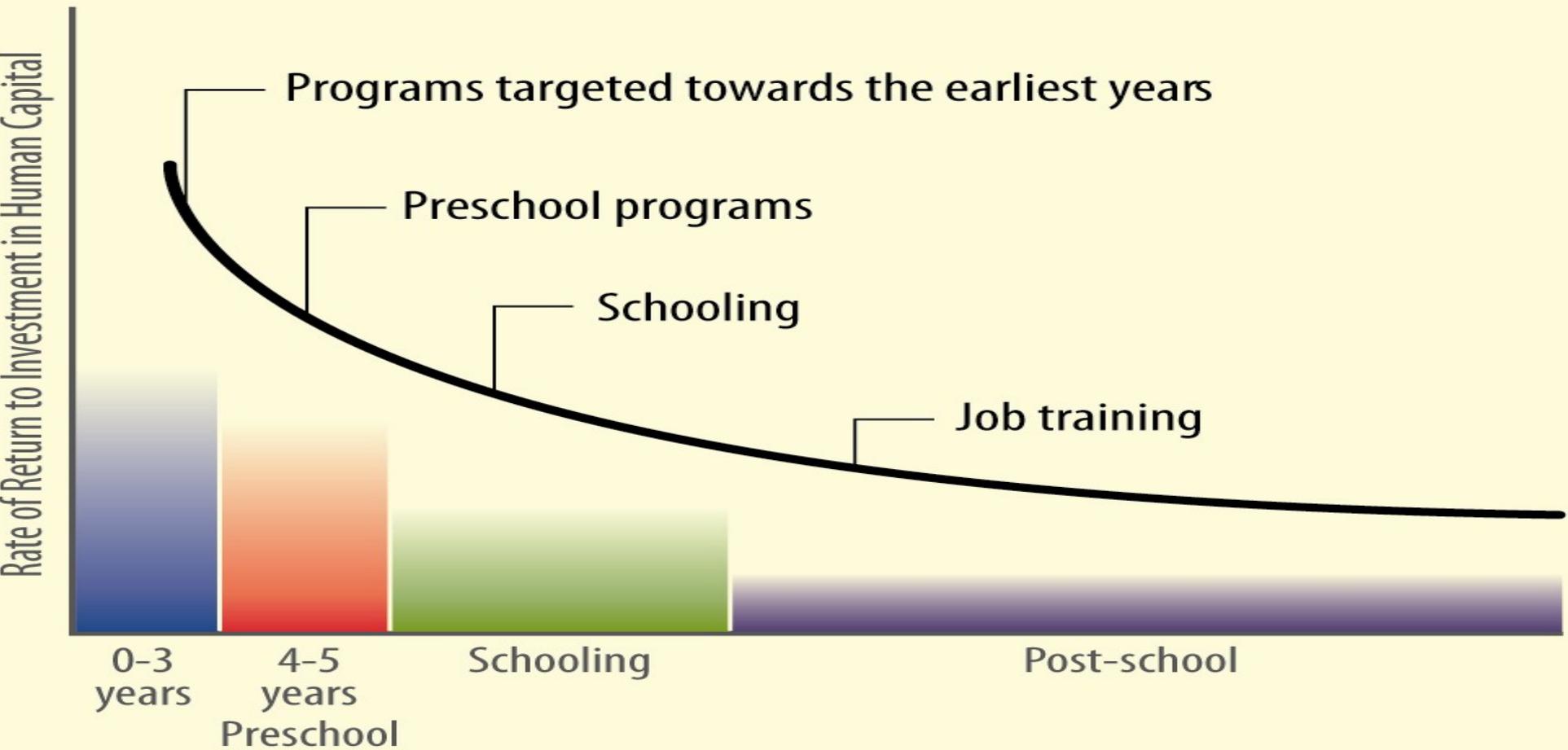
# When Does PFS Make Sense?



# When Does PFS Make Sense?

- From the standpoint of investors, PKSE Social Impact Bonds must have:
  - Strong state and local business, philanthropic and government support
  - Rigorous statistical demonstrations of projected benefits
  - Sound legal foundations for the PKSE bond issuing organization
  - Clear enforceable contracts among PKSE bond participating entities
  - Bonds or other PKSE assets with terms familiar to investors
  - Good working relationships with the investment underwriting, institutional and foundation investor sectors

# RATES OF RETURN TO HUMAN CAPITAL INVESTMENT AT DIFFERENT AGES



SOURCE: J.J. Heckman, "Skill formation and the economics of investing in advantaged children." *Science*, 312(5782):1900-2, (June 2006).

# Social Impact Bonds

## **Kauffman-ReadyNation Working Group finds Social Impact Bonds can help finance early childhood programs\***

- Social Impact Bond (SIB) programs will be able to --
  - ✓ Reduce pressures on state and federal budgets
  - ✓ Improve early child development and education
  - ✓ Strengthen K-12 education and workforce competitiveness
- SIB assets will be able to be --
  - ✓ Bought by for-profit and non-profit investors
  - ✓ Traded among investors worldwide and
  - ✓ Aggregated in asset-backed securities

*\*Robert Dugger and Robert Litan, Early Childhood "Pay-For-Success" Social Impact Finance: A PKSE Bond Example to Increase School Readiness and Reduce Special Education Costs, Kauffman- ReadyNation Working Group on Early Childhood Finance Innovation, March 2012*

# PKSE Bonds Provide Triple Bottom Line Investment Returns



**Societal – Creation of coalitions of hundreds of business leaders in every state who know which early child programs work, and who can shape state and federal policy.**

**Economic -- Higher third-grade reading and math scores, higher graduation rates, lower involvement in crime, fewer teen pregnancies, less drug use, higher rates of employment and future earnings, improved parent productivity, and stronger regional economic and per capita income growth.**

**Financial – Competitive interest rates. Principle repayment. First round, special-ed savings as a percent of philanthropic investment are almost 100%. Including returns from successive rounds increases first-round philanthropic returns significantly.**

# **A Simplified PKSE Bond Program Example Based on the Pennsylvania Pre-K Counts Study**

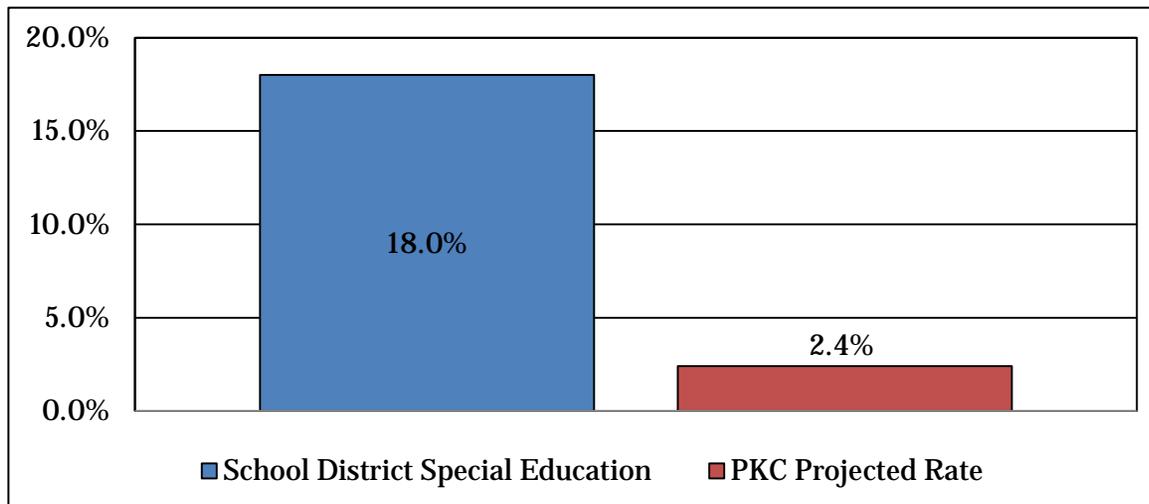
The sample program shows the performance results from providing regional preschool services to 100 pre-k students per year.

Each year is one “financing round”

Over ten years, pre-k services are provided to 1000 children.

# Statistical Projection Trial

- ✓ A comparison of **statistically predicted** results with **actual** special-ed assignment results was used to estimate the effects of PA's Pre-K Counts (PKC) program in reducing special-ed costs.
- ✓ 80% of 10,000 PKC children **met critical early school success competencies** in the Pennsylvania Early Learning Standards (OCDEL, PAELS, 2005) at transition to kindergarten.
- ✓ The gains of PKC children **exceeded the kindergarten transition skills** of same-aged peers on the BSSI-3 national norms in spoken language, reading, math, classroom behavior, and daily living skills.
- ✓ The projected PKC special education placement rate was 2.4%, **significantly lower** than the 18% historical special- ed placement rate of PA school districts.



Historical PA Special Ed  
Placement  
vs.  
Projected PKC Rate

# PKSE Program Parameters

|  |   |  |
|--|---|--|
| Special-ed assignment without PKSE preschool   | → | 18% (Equal to PA Pre-K Counts)                                     |
| Special-ed assignment with PKSE preschool Cost of prekindergarten per child per year | → | 7.5% (Three times Pre-K Counts)<br>\$7,850 (Equal to Pre-K Counts) |
| Cost of special-ed per child per year  | → | \$12,141 (PA school district data)                                 |
| Percent of spec-ed disabilities ameliorated by pre-k                                 | → | 70%  |
| Special-ed cost adjusted by amelioration rate  | → | \$8,499 (30% less than PA data)                                    |
| Number of years in special-ed  | → | Based on national distribution*                                    |
| Discount rate used to calculate present values                                       | → | 5%   |
| Migration out of the school district per year  | → | 2%**   |

\* The distribution of students in special-ed described in U.S. Department of Education, Office of Special Education Programs, Data Analysis System (DANS), OMB #1820-0043: "Children with Disabilities Receiving Special Education Under Part B of the Individuals with Disabilities Education Act," 2007. Data updated as of July 15, 2008.

\*\* 2% is an initial estimate of outmigration the seven county Northern Virginia area and is included in this PKSE example because it needs to be included in any analysis of SIB effectiveness.

# Pre-K and Special Ed

## All Major Early Childhood Research Shows Quality Pre-K Reduces Public School Special-Ed Costs

- ❑ **Randomized Control Trials** such as the Abecedarian and Perry Preschool studies
- ❑ **Case Control Trials** such as the Chicago Child-Parent Centers studies and the Louisiana LA 4 evaluation
- ❑ And **Statistical Projection Trials** such as the Pennsylvania Pre-K Counts and the Granite School District studies

***All show that quality pre-kindergarten for three and four year-old children is associated with very significant reductions in special education costs when the children are in K-12 public school education***

# **Notable PFS Projects**

- **Chicago Child Parent Center: \$16.9m**
- **Massachusetts Recidivism Reduction/Employment: \$21.3m**
- **New York City Rikers Island Recidivism Reduction Initiative: \$9.6m**
- **NY State Recidivism Reduction: \$13.5m**
- **Utah High Quality Pre School: \$7m**

# **Lehigh Valley Pay For Success Project**

- What is it
- Replication of Head Start Model
- Not all Head Start programs created equal
  - CSC program in nations 10 best
- History of the project
  - White House SIB
  - Institute for Child Success, Ready Nation conference
- Governor's RFP
- A \$10,000,000 program , 300 4 year olds per year
- Special purpose vehicle as the intermediary

# Outcome metrics

- Percentage of children ready for kindergarten as measured by Kindergarten Entry Inventory scale
- Percentage of children requiring continued special therapy and/or Individualized Education Plans (exclusive of severely developmentally disabled children such as those with brain damage)
- Number of children retained
- Percentage proficient in English language among dual-language users
- Percentage fully immunized and insured

# LV Project Savings

- **Healthy Children: \$XXXXXXX** over a 4-year period. Accrued by saving preventable ER visits and hospitalizations. Includes a 10% out-migration from the program.
- **Reduced Special Education: \$XXXXXXX** over a 4-year period. Accrued by reducing percentage of children needing special education from 18% to 2%.
- **Reduced English as a Second Language Instruction: \$XXXXXXX** accrued over a 4-year period by reducing the number of children entering kindergarten with Limited English Proficiency.
- **Children Ready for Kindergarten: \$XXXXXXXXXX** accrued over 4 years as a result of increasing the number and percentage of children proficient and ready from 53% to 85%. Includes children who will NOT require remediation, grade retention or IU assessments.
- **\$9,000,000** in total savings from these four items

# Why Should a Government Consider PFS/SIF?

- ✓ Can shift nonperformance risk from government to investors
- ✓ Focuses on outcomes-based contracts versus cost-reimbursement initiatives
- ✓ Independent evaluation creates transparency for all parties
- ✓ Attracts new forms of capital to the social sector for scaling
- ✓ Increases awareness of opportunity costs across multiple government agencies
- ✓ Increases data sharing and mining across agencies
- ✓ Creates opportunities to reinvest in successful programs and replicate over time
- ✓ Pennsylvania specific advantage, Keystone STARS

# Issues with PFS

- Complexity
- Possible need for randomized control group, other expensive evaluation
- Cost of development and issuance
- Need for a sophisticated lead entity
- Criticism of profit derived from providing a public good
- Limited track record

# Information Resources

- [www.readynation.org](http://www.readynation.org)
- [www.instituteforchildsuccess.org](http://www.instituteforchildsuccess.org)
- [www.thirdsectorcap.org](http://www.thirdsectorcap.org)