

**BEN BARTLETT**

CITY COUNCILMEMBER, DISTRICT 3

ACTION CALENDAR

January 31, 2023

To: Honorable Mayor and Members of the City Council
 From: Councilmember Ben Bartlett
 Subject: Outcomes Based Funding, Pay-For-Success and Social Impact Bonds

RECOMMENDATION

Qualified Positive Recommendation from the Berkeley City Council Budget & Finance Committee to:

Refer to the City Attorney to provide guidance on how the City can implement an Outcomes Based Funding initiative; request implementation analysis from the City Manager; and request information on whether or not this program can be used with external funds (e.g. grants) or city funds only

POLICY COMMITTEE RECOMMENDATION

On October 13, 2022, the Budget & Finance Committee adopted the following action: M/S/C (Arreguin/Harrison) to send the item to the City Council with a Qualified Positive Recommendation to refer to the City Attorney to provide guidance on how the City can implement an Outcomes Based Funding initiative; request implementation analysis from the City Manager; and request information on whether or not this program can be used with external funds (e.g. grants) or city funds only. Vote: Ayes – Harrison, Arreguin; Noes – None; Abstain – None; Absent – Droste.

BACKGROUND

Outcome Based Funding is a financing strategy in which Government allocates funding to vendors only upon the demonstrable achievement of specific outcomes. Under an Outcome Based Funding approach, Government enters into Contracts with non-internal-government organizations to deliver services intended to result in positive measurable outcomes. Often, in outcomes based fundings, private investors provide the funding and are repaid later by the government only if the service meets agreed-on performance benchmarks.¹ Outcomes Based Funding, Social Impact Bonds, or Pay for Success (PFS) Contracts can be an effective way for Government to reduce its spending while simultaneously achieving better social outcomes.

Outcomes Based Funding initiatives often work in close collaboration with Community Development Finance Institutions (“CDFI”). CDFI’s direct resources in communities with the potential for high social returns but with a lack of resources.

¹ Kasturi Rangan & Lisa A. Chase. “The Payoff of Pay-for-Success (SSIR).” <https://ssir.org/>, Stanford Social Innovation Review, 2015, https://ssir.org/up_for_debate/article/the_payoff_of_pay_for_success#

Outcomes-based funding supports evidence-based strategies to create better community outcomes and save taxpayer money.

Pay For Success was introduced by the Obama Administration; and is a strategy of obtaining positive social or environmental outcomes by paying, in part or in whole, for an intervention only once it produces those outcomes. Through PFS, government (or another entity) enters into a contract to pay for concrete, measurable outcomes once they are achieved for specific people or communities in need. Instead of funding services regardless of the results, payments are made only if interventions actually achieve the outcomes agreed upon in advance. For example, instead of paying for job training simply to be provided, a community might use PFS to pay only when individuals gain stable employment in good jobs. Where government employs PFS strategies, taxpayers no longer bear the risk of paying for services that are ineffective because resources are not expended until the services have produced a specific benefit².

Social Impact Bonds are an innovative financing mechanism in which governments or commissioners enter into agreements with social service providers, such as social enterprises or non-profit organizations, and investors to pay for the delivery of pre-defined social outcomes. More precisely, a bond-issuing organization raises funds from private-sector investors, charities or foundations. These funds are distributed to service providers to cover their operating costs. If the measurable outcomes agreed upfront are achieved, the government or the commissioner proceeds with payments to the bond-issuing organization or the investors. In reality, the term “bond” is more of a misnomer. In financial terms, SIBs are not real bonds but rather future contracts on social outcomes. They are also known as Payment-for-Success bonds (USA) or Pay-for-Benefits bonds³. There is healthy appetite for Social Impact Investing, currently there is more than \$700 billion in impact investment capital seeking deployment⁴.

Outcomes Based Funding and Social Impact Bonds are very similar in practice. They both include the practice of entering into a conditional contract with an organization to address social welfare programs. The payment to the organization is derived from the budgetary savings and other proceeds stemming from the resulting reduction in spending. This transfer of risk from Government to the vendor helps overcome resistance to funding innovative projects within a constrained budgetary environment.

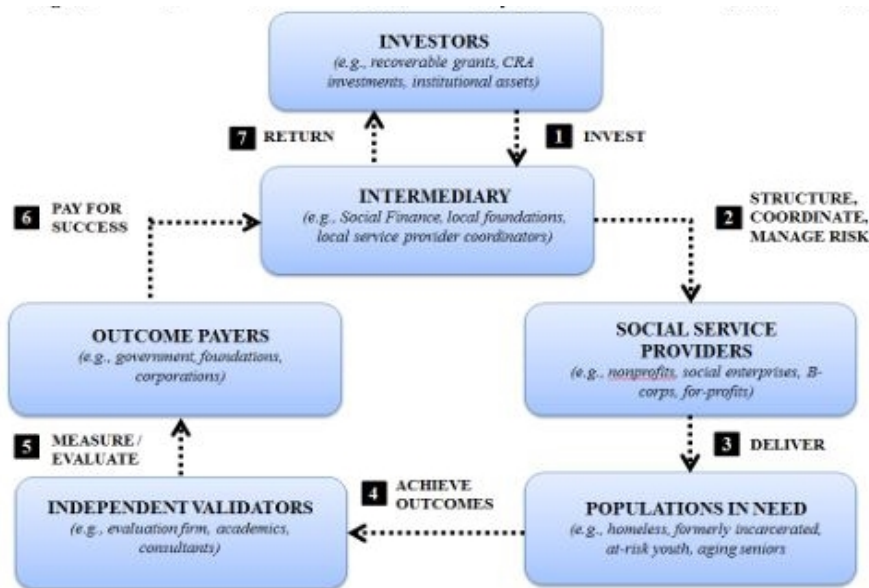
The Benefits of Outcomes Based Funding, Pay for Success, and Social Impact Bonds include:

1. Spurs Innovation
2. Saves Money
3. Transfers Risk from Tax Payer to Vendor
4. Better Outcomes for the Community

² “Pay for Success:” The White House, 2012, <https://obamawhitehouse.archives.gov/administration/eop/sicp/initiatives/pay-for-success>

³ Organisation for Economic Co-operation and Development, et al. “Understanding Social Impact Bonds.” OECD Working Papers, 2016, <https://www.oecd.org/cfe/leed/UnderstandingSIBsLux-WorkingPaper.pdf>

⁴ SG Analytics. “Impact Investing Market Size Is \$715 Billion: What Is the Future of Our Planet?” SG Analytics, SG Analytics, 2 Mar. 2021, <https://us.sganalytics.com/blog/impact-investing-market-size-is-715-billion-what-is-the-future-of-our-planet/>



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Here are a few examples of Outcomes Based Funding, Pay for Success, and Social Impact Bonds Models:

1. New York (1990s) – New York City dramatically changed the way it bought workforce development services from nonprofit providers working around the city. Instead of paying for the cost of services up front and hoping for the best, the city tied 100 percent of funding to measured performance. Job placement providers got paid only if they achieved clearly defined milestones (e.g., job placement, retention after set periods of time). The innovative focus on results yielded a number of benefits including, but not limited to, providers being incentivized to achieve outcomes that aligned with the city’s policy objectives, allowing the city to flexibly price (and re-price) outcomes it cared about while avoiding a more prescriptive, top-down approach to program design that can stymy innovation, and performance data helping the city make course corrections to the system as a whole. (When early program data showed poor job retention results, the city doubled down by changing payment formulas to incentivize longer-term retention outcomes.)⁶
2. Salt Lake City, Utah (2015) – Salt Lake County policymakers implemented innovative funding strategies to reduce incarceration and recidivism rates. In this particular case, a suite of evidence-based programs were funded through a social impact financing mechanism. If incarceration rates drop by an agreed-upon threshold percentage over a

⁵ Organization for Economic Co-operation and Development, et al. “Understanding Social Impact Bonds.” OECD Working Papers, 2016, <https://www.oecd.org/cfe/leed/UnderstandingSIBsLux-WorkingPaper.pdf>

⁶ Keele, Jeremy, and Sarah Peters. “HOW OUTCOMES-BASED FUNDING MODELS CAN IMPROVE THE EFFECTIVENESS OF STATE AND LOCAL GOVERNMENTS.” Sorenson Impact Center, 2017, pp. 134–37. https://investinresults.org/sites/default/files/book-chapter/WM_14_Keele-Peters_0.pdf

certain time frame, the county will repay the funders who provided the upfront bridge financing. If the programs are not successful, the county won't pay.⁷

3. USA (2008-2016) - President Barack Obama Administration's in Pay For Success⁸ initiative: The administration dedicated nearly \$100 million in funding to advance PFS through eight federal agencies. These federal dollars leveraged at least \$65 million in philanthropic, state and local funds for PFS. Among other important priorities, the Administration's PFS awards have been provided to help connect veterans with jobs⁹, build brighter futures for at-risk youth, support English language learners¹⁰, increase access to high-quality pre-K¹¹, reduce childhood asthma, support at-risk moms and their children, reduce homelessness, incarceration, and recidivism, and even promote natural resources conservation¹². Participants performed validation tests, feasibility studies¹³, transaction structuring, outcomes evaluation, outcomes payments, and cross-system data integration¹⁴. The U.S. is now the largest PFS market the world, with greater total outcome payment scale and impact investment dollars committed to projects than any other nation¹⁵.
4. Massachusetts (2014) Social Impact Bond Initiatives:
 - a. The Juvenile Justice Pay for Success Initiative was a managed Social Impact Bond project. The program's aim was to reduce recidivism and increase employment through intensive street outreach, targeted life skills training, education, and employment programming. The target group was 929 at-risk young men aged 17 to 23. Philanthropic grantors included The Kresge Foundation, Living Cities, Laura and John Arnold Foundation, New Profit Inc., and the Boston Foundation. Third Sector Capital Partners acted as the financial

⁷ Keele, Jeremy, and Sarah Peters. "HOW OUTCOMES-BASED FUNDING MODELS CAN IMPROVE THE EFFECTIVENESS OF STATE AND LOCAL GOVERNMENTS." Sorenson Impact Center, 2017, pp. 134–37. https://investinresults.org/sites/default/files/book-chapter/WM_14_Keele-Peters_0.pdf

⁸"Pay for Success:" The White House, 2012, <https://obamawhitehouse.archives.gov/administration/eop/sicp/initiatives/pay-for-success>

⁹"New VA – CNCS Collaboration to Connect Funding to Better Outcomes For." Whitehouse.Gov, 5 Jan. 2017, <https://obamawhitehouse.archives.gov/blog/2016/11/11/new-va-%E2%80%93-cnccs-collaboration-connect-funding-better-outcomes-veterans>

¹⁰ Office of the Press Secretary. "FACT SHEET: New Commitments Announced in Support of the My Brother's." Whitehouse.Gov, 17 Oct. 2016, <https://obamawhitehouse.archives.gov/the-press-office/2016/10/11/fact-sheet-new-commitments-announced-support-my-brothers-keeper>

¹¹ US Department of Education (ED). "Pay for Success." U.S. Department of Education, <https://www2.ed.gov/about/inits/ed/pay-for-success/index.html>. Accessed 2 July 2022.

¹² Goldfuss, Christy, and David Wilkinson. "Pay for Success: New Resources for Better Conservation Outcomes." Whitehouse.Gov, the White House, 5 Jan. 2017, <https://obamawhitehouse.archives.gov/blog/2015/12/17/pay-success>

¹³ Munoz, Cecilia, and Shaun Donovan. "Administration Nearly Doubles Number of 'Pay for Success' Feasibility." Whitehouse.Gov, the White House, 19 Apr. 2016, <https://obamawhitehouse.archives.gov/blog/2016/04/19/administration-nearly-doubles-number-pay-success-feasibility-studies>

¹⁴ Wilkinson, David, and Wendy Spencer. "How Data and Innovation Can Help People." National Service Archived Blog, 13 Oct. 2016, <https://nationalservice.tumblr.com/post/151761667357/how-data-and-innovation-can-help-people>

¹⁵ "Pay for Success:" The White House, 2012, <https://obamawhitehouse.archives.gov/administration/eop/sicp/initiatives/pay-for-success>

intermediary and prime contractor. Third Sector was responsible for arranging project funding, overseeing project implementation, distributing funding to Roca and managing repayment to funders. It is worth noting that Third Sector Capital Partners is deferring \$50 000 USD of its management fees; it will only be paid that portion of its fees if results are achieved. New Profit Inc. The Juvenile Justice Pay for Success Initiative is an individual SIB, but it is also part of the Massachusetts Social Innovation Financing Trust Fund.¹⁶

- b. The State of Massachusetts, the nonprofit Roca, the financial intermediary Third Sector Capital Partners, and a group of investors entered into a contract under which Roca was paid by investors to operate a program designed to prevent formerly incarcerated young people from returning to jail. Under an Outcomes Based Funding and Pay for Success Model, the state would repay the investors only if Roca met or exceeded the contract goals. Massachusetts was willing to repay the loan with interest to investors because the program saved even more money by keeping young people out of prison. While the result of this program was inconclusive, the State of Massachusetts will only have to pay Roca if the model is successful.¹⁷
5. New York State (2012) – New York implemented a Social Impact Bond model where the State of New York partnered with Social Finance, a nonprofit social impact financing and advisory firm, to reduce recidivism through a Social Impact Bond contract. After analyzing the needs of high-risk formerly incarcerated individuals and conducting thorough due diligence on interventions and social service providers, Social Finance selected CEO, a nonprofit employment service agency for formerly incarcerated individuals, as the entity to deliver the intervention. The State of New York, Social Finance, and CEO worked together over the next year to structure the project with the help of law firm Jones Day. The State of New York also obtained pro bono technical assistance from the Harvard Kennedy School Social Impact Bond Technical Assistance Lab (“SIB Lab”) to develop and implement the project¹⁸ This Social Impact Bond managed to reduce the number of bed days for former inmates therefore directly reducing the State of New York’s public spending and increasing the well being for the participants.
 6. Ohio State (2014) – Cuyahoga County, Ohio, the local government entered into a Social Impact Bond contract with FrontLine to reduce time spent in foster care for children of homeless mothers. FrontLine had devoted 26 years to providing comprehensive services to mentally ill homeless people, with the goal of transitioning its clients to

¹⁶ Organization for Economic Co-operation and Development, et al. “Understanding Social Impact Bonds.” OECD Working Papers, 2016, <https://www.oecd.org/cfe/leed/UnderstandingSIBsLux-WorkingPaper.pdf>

¹⁷ Kasturi Rangan & Lisa A. Chase. “The Payoff of Pay-for-Success (SSIR).” <https://ssir.org/>, Stanford Social Innovation Review, 2015, https://ssir.org/up_for_debate/article/the_payoff_of_pay_for_success#

¹⁸ The State of New York, et al. “Investing in What Works: ‘Pay for Success’ in New York State Increasing Employment and Improving Public Safety.” Harvard Kennedy School Government Performance Lab, 2014. <https://govlab.hks.harvard.edu/>, https://govlab.hks.harvard.edu/files/govlabs/files/nys_ceo_pfs_project_summary.pdf

permanent supportive housing. FrontLine had also demonstrated that moving homeless mothers to stable housing increased their chances of recovering and regaining custody of their children from foster care. The county's data revealed that children of homeless mothers spent considerably more time in foster care than other children (724 days compared to 440 days) at a daily cost of \$75 per child. Keeping mothers in stable housing with their children therefore represented significant savings for the county.¹⁹

7. Saskatchewan, Canada (2014) – The Canadian Province of Saskatchewan Sweet Dreams, implemented a Social Impact Bond to increase the well being of lowincome families. The Government of Saskatchewan and the Ministry of Social Services, held direct contracts with the investors and the service provider, Saskatoon Downtown Youth Centre (EGADZ). The investors provided in May 2014 \$1 million CAD for a period of 60 months to the EGADZ to offer to single mothers with children under the age of eight, who are at risk of requiring services from Child and Family Services, with affordable housing and support. At the same time, the mothers can complete their education, secure employment, or participate in pre-employment activities, such as life skills training and parenting classes. In the end, the SIB succeeded in helping keep single mothers in the schools and helped keep those families together.²⁰

The City's budgetary constraints are becoming more pronounced. Meanwhile a looming recession is poised to exacerbate the City's growing social needs. Berkeley should explore new tools to drive innovation to more cheaply achieve greater community outcomes.

CURRENT SITUATION

The City has many challenges from homelessness, health, environmental impact, public safety, and many more that demands financial and external costs that could use more preventative measures to save on costs. The guidance on how the City can implement an Outcomes Based Funding and Social Impact Bond Initiative would allow the City to have more options to achieve greater outcomes for less money.

FINANCIAL IMPLICATIONS

Staff time from the City Attorney's Office.

CONTACT PERSONS

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¹⁹ Kasturi Rangan & Lisa A. Chase. "The Payoff of Pay-for-Success (SSIR)." <https://ssir.org/>, Stanford Social Innovation Review, 2015, https://ssir.org/up_for_debate/article/the_payoff_of_pay_for_success#

²⁰"Sweet Dreams Supported Living Project." The Government Outcomes Lab, Sept. 2020, <https://golab.bsg.ox.ac.uk/knowledge-bank/indigo/project-database/sweet-dreams-supported-living-project/>