Changes in Philanthropy: Emerging Outcomes Based Funding Environment

Presented for:

Children & Families Commission of Orange County Annual Planning Meeting

Presented by:

Jessica LaBarbera
Director, Nonprofit Finance Fund

June 4, 2014
<table>
<thead>
<tr>
<th><strong>Access to Capital</strong></th>
<th><strong>Strategic Financial Analysis, Management &amp; Planning Services</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and Lines of Credit</td>
<td>Financial Diagnostics, Program Economic and Scenario Modeling, Capitalization Planning</td>
</tr>
<tr>
<td>New Market Tax Credits</td>
<td>Business Model Analysis, Modeling &amp; Repositioning</td>
</tr>
<tr>
<td>PRI Services</td>
<td>Strategic Collaboration Planning</td>
</tr>
<tr>
<td>Pooled Financing Programs</td>
<td>Facility and Reserve Planning</td>
</tr>
<tr>
<td>Growth Capital Services</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Impact Investing</strong></th>
<th><strong>Thought Leadership &amp; Partnership</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Field Development</td>
<td><strong>Pay-for-Success and Social Impact Bonds</strong></td>
</tr>
<tr>
<td>Capital Aggregation</td>
<td><a href="http://www.payforsuccess.org">www.payforsuccess.org</a></td>
</tr>
<tr>
<td>Philanthropic Advisory Work</td>
<td>Studies of the Nonprofit Economy</td>
</tr>
<tr>
<td>Provider Readiness Trainings</td>
<td>Advocacy on Funder Policies and Practices</td>
</tr>
<tr>
<td>Complete “Stacked” Capital</td>
<td>Publishing, Expert Commentary, Keynotes, Workshops &amp; Panels</td>
</tr>
<tr>
<td>Structured Finance</td>
<td></td>
</tr>
</tbody>
</table>
Act as an independent, honest broker to the “PFS” field

- Support various PFS approaches and stakeholders as they explore this new “outcomes-based” financing model
- Spread recognition of why and how the PFS outcomes-based financing approaches can be effective
- Identify, disseminate and support PFS structures that can work
- Build and manage structured partnership initiatives for accelerated learning and application of PFS among stakeholders
- Incubate and accelerate providers’ capacity to thrive in an outcomes-based environment

Establish a centralized and interactive education platform for information, best practices sharing and dialogue on PFS – the NFF Learning Hub: [www.payforsuccess.org](http://www.payforsuccess.org)
Outcomes-based Finance: The Missing Hub in the Wheel of Systemic Change?

Key Points:

- Ongoing Market Shift from Outputs to Outcomes
- Affordability and Capability of Measurement Technologies
- Structural Budget Reductions at Federal, State & Local Levels
- Scarcity of Providers’ Legacy Sources of Revenue
- Need for Repositioning of Provider Business Models
- Impact Investing
- Social Enterprise

Pay for Success & Outcomes-based Finance
Pay for Success: A Model that Drives Towards Outcomes

- **A contract** (not necessarily a bond) that:
  - Connects performance outcomes to financial return
  - Monetizes social impact/outcomes
  - Realizes costs savings (typically for government)
  - Leverages private capital

- **Innovative integration** of evolving practices (i.e., pay for performance, outcomes measurement) in the social sector at an opportune time—*aligns interests in achieving social outcomes*

- **Social Impact Bond** is one of potentially many ways to *capture the embedded values and linkages of pay-for-success financing*
Pay for Success: How a Transaction “Flows”

Original and piloted structure (Peterborough) effectively creates and incentivizes mutual interest in achieving outcomes.

**FIGURE 1 SOCIAL IMPACT BOND MECHANICS**

1. **Investors**
   - Make long-term investment
   - Repay principal + ROI

2. **Fund & oversee less costly, evidence-based prevention programs**

3. **Nonprofit**
   - Produce improved outcomes that reduce demand for remediation services

4. **Government**
   - Pay only for programs that work; retain % of savings

5. **Intermediary**

Source: Social Finance USA: Adapted from Jeffrey B. Liebman, "Social Impact Bonds," Center for American Progress (February 2011)
Pay for Success: Embedded Values

A New Approach for Financing Certain Social Programs

1. Multi-year Contract from private investors for preventative services delivered by qualified provider(s)

2. Invested capital supports positive outcomes that produce cash flow savings and/or revenues against legacy government program costs

3. Investment Success = Achieving contractually agreed social outcome targets (Metric and Timing)

4. Measurement of Social Outcomes against contracted targets is done by independent experts

5. Most or all outcome performance risk is shifted from the government funder to private investors and/or providers

6. Government Funder is obligated to pay investors from portion of cash flow ONLY IF contracted social outcome targets are hit

7. Government Funder pays nothing if targets not reached OR retains a contracted portion of cash flow from successful investments
Pay For Success: US Market Evolution

Summer 2012

- New York City – launched first fully-funded Social Impact Bond (SIB) transaction in U.S.
- Massachusetts – announced two SIB contracts (*unfunded*)
  - One contract to address recidivism among youth
  - Second contract to address chronic homelessness in Boston area

2013-2014

- First Early Education SIB Pilot Announced (Salt Lake City)
- NY State SIB launched
- MA ROCA transaction launched

Today

- Over 30 State, County and Municipal Governments Assessing Feasibility and Developing Pay-for-Success Projects
  - *Intervention under consideration in Chicago, Philadelphia, SC, MI, CA, CO, IL, OR, VT, NJ*
  - *NFF/Irvine CA PFS Initiative*
- Pay-for-Success being incentivized at the Federal Government Level
  - Federal Budget Proposals
  - Department of Labor - $20 million
  - Department of Justice - Second Chances Act (recidivism reduction)
### Promising Programs & Approaches in the Early Childhood Space

<table>
<thead>
<tr>
<th>Programmatic Approach</th>
<th>Organization</th>
<th>Target Population</th>
<th>Outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-school setting with structured data tracking</td>
<td>Voices for Children Utah, Granite City School District</td>
<td>At-risk Preschool – age children</td>
<td>Reduction in need for special education services, education benefits include improved 3rd grade scores. Longer term benefits include reduced crime, better wages.</td>
</tr>
<tr>
<td>Home visitation program by RNs</td>
<td>Nurse Family Partnership</td>
<td>Low-income, first time mothers &amp; children</td>
<td>Improved prenatal health, intervals between births, maternal employment, child school readiness Fewer childhood injuries &amp; subsequent pregnancies</td>
</tr>
<tr>
<td>Triple P (Positive Parenting Program)</td>
<td>Multiple</td>
<td>At Risk Families with children 0-8</td>
<td>Reduced rates of child maltreatment, fewer foster placements, fewer hospitalization/ER visits for child maltreatment</td>
</tr>
<tr>
<td>Pre-school setting with structured data tracking</td>
<td>Pre-K Counts (multiple partners)</td>
<td>At Risk Preschool Children in PA</td>
<td>Improved kindergarten readiness</td>
</tr>
</tbody>
</table>

**Pre-K Counts**

- **Program:** Pre-K Counts
- **Organization:** Pre-K Counts (multiple partners)
- **Target Population:** At Risk Preschool Children in PA
- **Outcomes:** Improved kindergarten readiness
Utah High Quality Preschool Program

- Goals of increasing access to preschool, increased school readiness and decreased use of special education services
- **Success payments tied to decreased use of special education services through 6th grade**
- Private capital enables 450-600 3 and 4 yr olds in yr 1 to attend pre-school; potential to reach over 3,5000 over 5 yrs
- Up to $4.6M from Goldman Sachs and $2.4M subdebt from J.B. Pritzker Foundation to finance an expansion of the Utah High Quality Preschool Program in Granite and Park City School Districts
- United Way of Salt Lake oversees preschool programs implementation and manages repayments to private investors
- Public funding from County School Districts and State Department of Education provide repayment
Nurse Family Partnership: PFS pursuit as a means to scale delivery

- Targets high-risk (low-income) mothers’ first pregnancies
- Home visitation by registered nurses from pregnancy – age 2
- Effectiveness proven in 4 random controlled trials plus > 20 other rigorous evaluations
- Cost-benefit analyses showing positive ROI
- NFP infrastructure supports replication with fidelity to model

Possible Health Outcomes for PFS Contract:
- Fewer pre-term births, infant deaths, child emergency department visits, closely spaced second births, subsequent births or subsequent preterm births
- Increase in children fully immunized

Possible Other Outcomes for PFS Contract:
- Child welfare: Fewer incidences of child abuse or neglect
- Education: Fewer remedial school services through age 6
- Criminal justice: Fewer youth crimes through age 17
- Maternal life-course: Increased employment, decreased TANF use
California PFS Initiative

With initial support of **$2.5M from the James Irvine Foundation**, NFF is implementing a California PFS initiative

- The core initiative goal is to **close 3 PFS deals in CA in 2 years**, and to create a cohort of PFS leaders to capture and disseminate knowledge about the process

- ~$2M of the grant will be used to offer **technical assistance** to leaders aiming to close PFS deals in their communities

- NFF will manage the provision of technical assistance to the leaders through **qualified intermediaries**

- NFF will also manage the creation of an **Funder Interest Group**, which will give feedback to leaders on deal structure and potentially offer investments for PFS deals

- NFF will create a **community of learning** among cohort leaders to accelerate the sharing of lessons learned and disseminate those lessons more broadly within the PFS field in CA
## Framework for Considering Stages of PFS Project Development

<table>
<thead>
<tr>
<th>Stage 1: Exploration</th>
<th>Stage 2: Pre-Structuring</th>
<th>Stage 3: Transaction Structuring</th>
<th>Stage 4: Shovel Ready</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conversation among local stakeholders is occurring</td>
<td>Informed consideration or due diligence of effective interventions/programs that could be right for PFS in a community is underway</td>
<td>Governments (or the back-end payors in a non-governmental transaction) have reviewed the due diligence completed for a potential project and committed to moving forward with structuring a PFS transaction</td>
<td>Most, if not all, stakeholders (providers, evaluators, intermediaries, government agencies) have committed to the project</td>
</tr>
<tr>
<td>Education efforts have been undertaken/are under way</td>
<td>Evidence to support the efficacy of such high-impact programs is being collected and evaluated by stakeholders</td>
<td>A third party is engaged to structure a transaction, refine the program design and consider the delivery implications of a scaled project</td>
<td>The transaction has been substantially structured; Exact program design elements may need to be finalized</td>
</tr>
<tr>
<td>Initial ideas for suitable PFS projects are being discussed, considered, prioritized</td>
<td>Governments are undertaking (or engaging third parties to undertake) feasibility assessments and/or cost benefit analyses that look at the relative merits of scaling or implementing programs in a community</td>
<td>A procurement process (or direct engagement) of involved parties (providers, evaluators and intermediaries) takes place</td>
<td>Investors, investor terms or specific project design elements may remain outstanding/need to be negotiated</td>
</tr>
<tr>
<td>Government officials have expressed interest in PFS</td>
<td>Such feasibility assessments or cost benefit analyses determine the potential cost savings generated by projects under consideration</td>
<td>Potential investors are engaged</td>
<td>Contracts need to be negotiated</td>
</tr>
<tr>
<td>Barriers to Systemic Adaptation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>--------------------------------</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gaps in Data, Evaluation, Evidence Base</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Early Stages/Proof</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Flawed Funding Systems</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Organization &amp; Funder Readiness</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uncertainties over cost of measurement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scaling/Replication challenges</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Challenges for Building an Outcomes Based Financing Environment**
Inflection Point in the Systemic Shift from “Outputs” to “Outcomes”

The Appeal and Possibilities of PFS Embedded Values And Linkages

Promotes more efficient and effective outcomes-driven service delivery: programs that work

Monetizes the positive social impact of prevention & early intervention

Cost savings or revenues plus lower risk to governments compared to current practices

Aligns interest of investors, providers & governments on positive social outcomes

Integrates social & financial ROI for the private impact investor pool and suggests scalability

More productive allocation of risk among investors, governments & service providers
Considerations for Assessing Service Provider “Right Fit” and Readiness

- Deliver preventative or early intervention programs
  - Government funding provides a substantial percentage of support for these programs
  - Program provision can provide financial benefit to government funders

- History of evidence-based outcome metrics to evaluate performance
  - Track record of success in achieving outcome targets in reasonably compact timeframe (1 to 6 years)

- Organizational capacity to:
  - Reach population needed for statistical significance
  - Collaborate with other providers
  - Ability to track capital investment (and perhaps create business models)

- Governing body supportive of PFS participation, capacity demands and reputational risk involved

- Financial health and durability required for participation
## Different Kinds of Capital Address Different Needs

<table>
<thead>
<tr>
<th>Capital Types</th>
<th>Function of each</th>
<th>Addresses:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working</td>
<td>Allows the organization to bridge revenue timing gaps</td>
<td>Liquidity</td>
</tr>
<tr>
<td>Risk &amp; Opportunity</td>
<td>Absorbs unforeseen funding losses or unexpected, extraordinary expenses</td>
<td>Adaptability</td>
</tr>
<tr>
<td>Change</td>
<td>Funds investments in infrastructure and capacity associated with changes in business model, may cover deficits until programs and operations can support themselves</td>
<td>Adaptability, Durability</td>
</tr>
<tr>
<td>Recovery</td>
<td>Allows an organization to address a historical mistake or chronically undercapitalized operations</td>
<td>Durability</td>
</tr>
<tr>
<td>Facilities &amp; Equipment</td>
<td>Supports acquisitions or upgrades, or can be used to accumulate reserves to meet future facility and equipment needs</td>
<td>Durability</td>
</tr>
<tr>
<td>Endowment</td>
<td>Provides ongoing operating funds through investment income</td>
<td>Durability</td>
</tr>
</tbody>
</table>
Change Capital (not revenue!) Promotes Adaptability & Durability

There are two kinds of funding:

- **Revenue from “Buyers”** provides regular revenue
  - Covers annual costs of programs & operations
  - Ticket sales, membership fees, program grants, contracts, etc.

- **“Change” capital from “Builders”**
  - Funds the enterprise: to transform what it does
  - Tends to be episodic in nature
  - Can enable growth and experimentation, or provides for risk reserve or deficit coverage

**Nonprofits need both revenue and capital to thrive!**
General Lessons Learned (to date)

- **Local Context Matters:** Recent US PFS/SIB activity has organized differently according to local conditions—initial champions have varied, as have resulting structures. One size will not fit all.

- **Independent & Trustworthy Voice Needed:** Given different interests and natural tensions between government, service providers, intermediaries, and investors, maintaining trust among all parties as an objective broker is essential to mobilizing the effort.

- **Catalysts Can Drive Timing:** Government processes and approvals differ. Even with MA/NYC experiences to draw from, RFPs and contracting can still require extended time periods. Moving aggressively through the process requires an incentive.

- **Targeted Technical Expertise Will Be Required:** Depending on capacity of local players, stakeholders will likely need tailored modeling structuring and facilitation support.

- **Broad Stakeholder Engagement is Essential:** Government champion is critical, but not independent of the stakeholder group, including capable intermediaries, strong service providers and evaluators, and engaged investors.
Thank You!
To Stay Connected...

Learn More
nonprofitfinancefund.org

Twitter
twitter.com/nff_news

Facebook
facebook.com/nonprofitfinancefund

Our Blog
philanthropy.com/blogs/money-and-mission

Sign Up
nonprofitfinancefund.org/sign-up

RSS
nonprofitfinancefund.org/news/feed

PFS & SIB
www.payforsuccess.org

Get in Touch!
Jessica LaBarbera
jlabarbera@nff.org
213-623-7001x5