



Date: June 8, 2017
To: Patrick H. West, City Manager *T.H.W.*
From: Kelly Colopy, Director of Health & Human Services *KC*
For: Mayor and Members of the City Council

Subject: Social Impact Bonds

On September 13, 2016, the City Council requested the City Manager to report back regarding Social Impact Bonds, and to provide recommendations for the implementation of any policy reforms or additional programming that is consistent with the goals this opportunity could provide. In response to the City Council request, the Health and Human Services Department has compiled the following report.

Social Impact Bonds: What are they?

Social Impact Bonds (SIBs), otherwise known as Pay-for-Performance contracts, are a financial mechanism in which investors pay for a set of interventions to improve a social outcome that is of interest to a government. If the social outcome improves, the government repays the investors for their initial investment plus a return for their financial risks. If the social outcomes are not achieved, the investors stand to lose their investment. While a number of models exist, the underlying foundation is that government identifies a desired social outcome, such as reducing the number of chronic homeless, reducing jail recidivism, or increasing school readiness, and looks to fund interventions such as supports for those in housing, mental health services, or pre-school opportunities. SIBs are focused on services and are not used for capital investments. For example, SIBs will not pay for building housing, but will pay for the case management and treatment needs of those in the housing.

Background of Social Impact Bonds

In 2010, the world's first SIB issuance was completed in the United Kingdom. Since then, approximately 60 SIB transactions have been implemented across 15 countries with 85 percent of the transactions issued outside of the United States (U.S.) As of June 2016, nine SIB transactions have been implemented in the U.S.

As of February 2017, 15 SIBs have been launched in the U.S. to fund approximately \$130 million in services for 20,000 individuals. Four of these projects aim to reduce recidivism in the criminal justice system; five are providing supportive services to formerly homeless individuals and families; and four projects address early childhood. Three of the 15 projects

have reported results. In May 2016, the first payment was earned for a Chicago project expanding access to high quality preschool. The payment was made on the basis of intermediate measures that included kindergarten readiness. A payment was also made in a Utah pre-K project but it is controversial as there was no control group in the evaluation design. Finally, a Rikers Island project, designed to reduce recidivism in the criminal justice system, was suspended when the program results were below target.¹

Designing and Implementing a Social Impact Bond

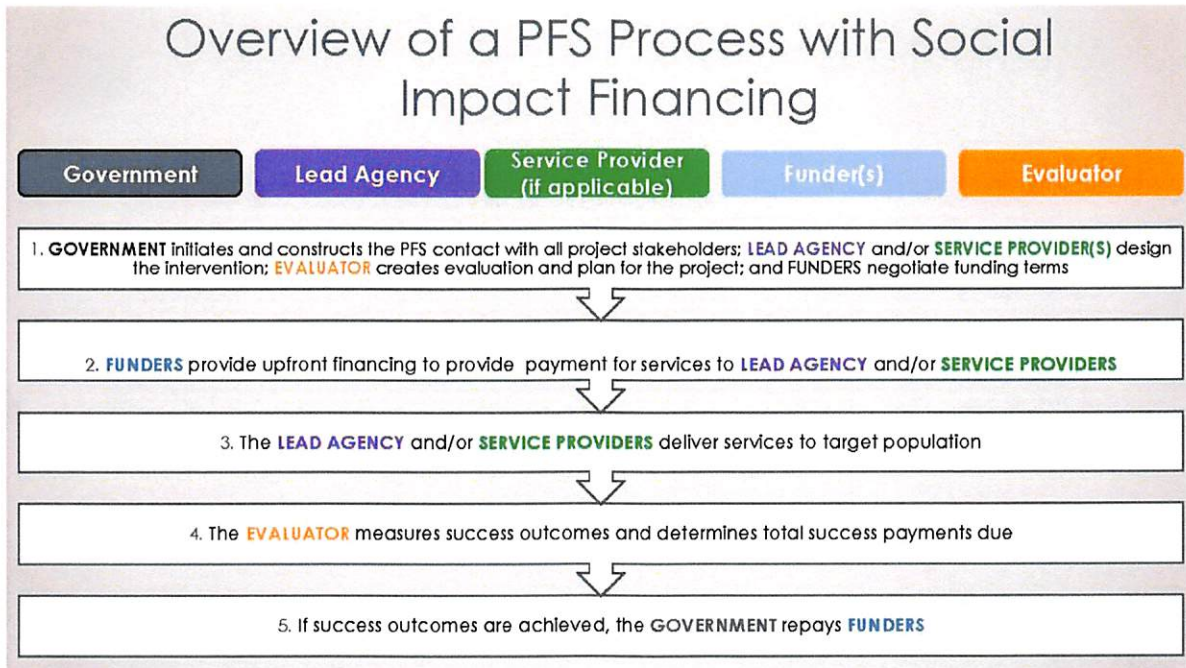
While the concept of Social Impact bonds is straight forward, it has extremely complex transactions that involve partnerships between governments, non-profit organizations and investors. Each SIB project must be designed and negotiated individually to meet the goals of the initiative and the partners involved. One critical component to these deals is how to measure success, which requires external assistance to structure, evaluate risk, and put measurement systems in place. While there are outside entities that can assist cities with how to structure SIBs, a significant amount of city staff time and other in-kind support are still required. Due to the complexity of these transactions, SIBs generally take approximately three years or more to issue. During the three-year period, issuers research and gather statistical data, set performance measures, and establish partnerships with governments, non-profit organizations, and investors.

Generally, SIBs are issued through a private placement. Each SIB transaction is distinctive and structured differently. The terms, conditions, and repayment methods are agreed upon by the issuer and the banking institution, and are not disclosed to the public. However, private placement transactions, as compared to a traditional bond issuance, typically have higher interest rates ranging from 5 to 10 percent. Due to the complexity of these transactions, the costs of issuing SIBs are also generally higher than other financing types. At least one other jurisdiction has concluded the start-up cost of designing and negotiating a contract would likely exceed the projected savings of the program. Furthermore, it is not clear if social impact bonds would be considered a general obligation of the City backed by the General Fund and, therefore, require a vote of the people. This would likely depend on how it is structured and the repayment source.

The Santa Clara County SIB funds support permanent supportive housing for 150 to 200 chronically homeless individuals who are high utilizers of emergency rooms, jail and/or mental health services. Seven funders were engaged to generate \$6.9 million in capital for the effort with \$8 million in success payments over six years. Massachusetts is funding 500 units of stable, supportive housing for up to 800 individuals who are high utilizers of emergency rooms and shelters. Three investors generated \$3.5 million in capital with \$6 million in success payments. The state is also participating in supporting this effort.

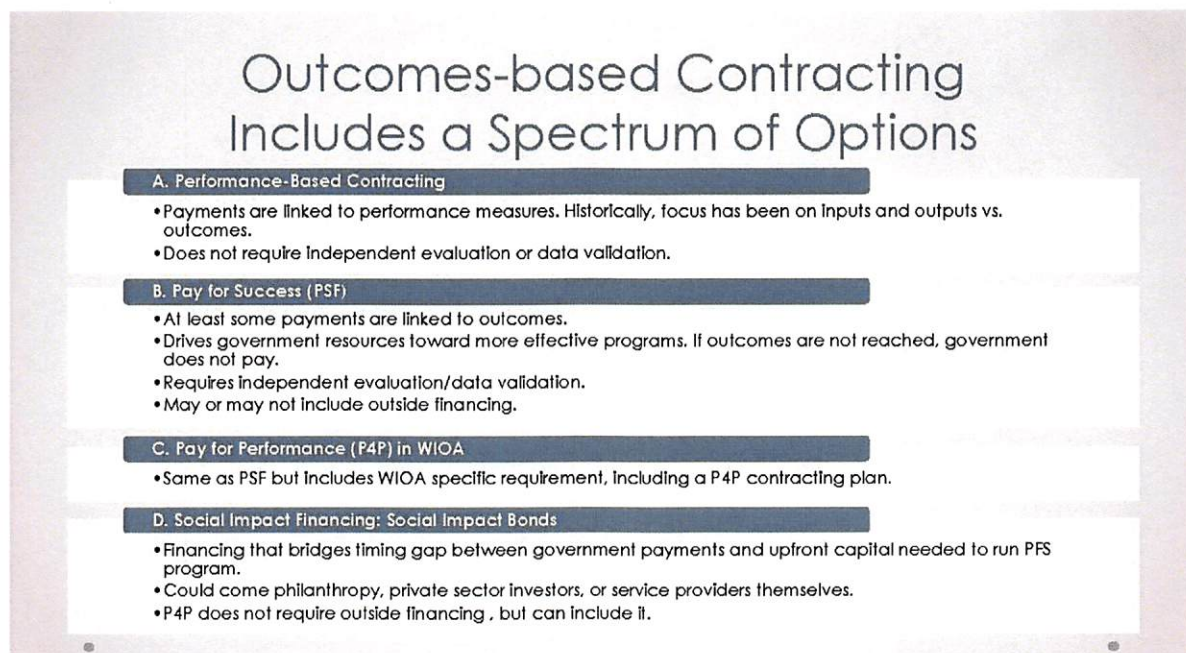
¹ HKS, Government Performance Lab, Social Impact Bonds 101.
http://govlab.hks.harvard.edu/files/siblab/files/sibs_101_hks_gpl_2017.pdf

The general steps to developing a social impact bond pay for success project is outlined below.



Pay-for-Success Opportunity in Long Beach

Outcomes-based contracting can be conducted at different levels as outlined in the table below. The SIB option is similar to the pay-for-success model but brings in the outside funding.



In Long Beach, Pacific Gateway is implementing a Pay-for-Success (PFS) strategy using Workforce Innovation and Opportunity Act funds. This PFS program recruits organizations and businesses in the community to become “success coaches” providing career coaching and workforce development in partnership with Pacific Gateway to young people ages 16-24, who are not connected to school or employment and fit one or more of the following situations: a school dropout; youth who are school-age but have not attended in the last school quarter; a youth who graduated but is low-income and skills-deficient or an English language learner; in the juvenile or adult justice system; a homeless individual, a runaway, an individual who is in foster care or has aged out of the foster care system; an individual who is in an out-of-home placement; an individual who is pregnant or parenting; or an individual with disability.

The Request for Proposals for the program discussed above outlines specific deliverables (or pay points) for each activity undertaken by the success coaches. A provider will receive 50 percent of their funding as a base fee-for-service payment and up to an additional 50 percent of the funding when the youths they mentor hit specific benchmarks. It will be necessary for the providers to leverage linkages and partnerships existing in the community to achieve the outcomes and receive the performance payments.

Recommendations

Given the extensive timeframe, technical support and data needs to design and implement Social Impact Bonds, we recommend the following:

- Monitor the successes and lessons learned from the PFS project through Pacific Gateway.
- Start to experiment with introducing payments contingent on performance into the City’s social service and, possibly, other contracts where applicable and effective. This will encourage City staff and service providers to regularly examine the data on project results and re-engineer the services as needed.
- Identify areas of operations that the City believes would benefit from additional funding that can be achieved through a SIB. SIBs generally are used to fund initiatives that tackle difficult social problems like homelessness, recidivism, and youth unemployment. They provide funding for expanding promising practices while rigorously evaluating their effectiveness to ensure ineffective programs do not continue to receive funding.
- Leverage the current efforts of the Innovation Team (i-team) to improve and increase data collection and sharing to build the City’s capacity to collect and report data required for SIBs. The i-team is currently focused on public safety with an emphasis on developing solutions to divert high frequency offenders in Long Beach to more appropriate services. As part of this effort, the City Manager recently signed Administrative Regulation 8-32 as a policy step toward developing a third party data warehouse that will integrate City data systems. This Regulation confirms that the City is a single legal entity, made up of 24 departments, and that City departments may share individually identifiable, protected health, and criminal justice information with the intent to better understand individual and aggregate client needs, to better align and coordinate services, and to improve understanding of the full costs and success rates for serving individuals and specific populations for the City as a whole. Leveraging these efforts will allow a more thorough assessment of the cost of homelessness to the City across multiple departments including Health and Human Services, Police, Fire, Public Works, Libraries, and Parks, Recreation and Marine.

- Strengthen partnerships to access data regarding impacts on community providers regarding topics of interest for PFS opportunities.
- Initiate conversations to prioritize City resources to align with those topics having the greatest impact on our City's resources and community, primarily through the budget process. Leveraging the new data opportunities discussed above and utilizing existing studies of impact and potential outcomes in comparable jurisdictions, would allow for designing a mechanism to account for social costs of an issue such as homelessness. This would allow for more data-informed decision-making regarding the City's investments to address social issues. In future budget years, resources may be invested internally in prevention and social supports. "Savings" would be accounted for in a way that outlines increased ability to provide services in the City, but will likely not result in a reduction in spending. For example, investing City resources towards homeless prevention and supportive services for those who are chronically homeless may reduce the overall cost to the City of combating homelessness by lowering demands on the resources of the Departments of Health and Human Services, Public Works, Police, Fire, Libraries, and Parks, Recreation and Marine. This would allow the resources of these Departments to be utilized more effectively for other services. Building the City's data capacity will be important to document these savings. This effort would require partnership and financial and research staff across City departments. If existing staff are not available to support this effort, the Department of Health and Human Services would seek outside funding and/or consultants to support the research efforts.
- Determine consulting supports to determine data structures necessary to allow for social impact investing. Continue to track the progress of SIBs around the country and engage with a design consultant when data structures are prepared.

The City is poised for many innovative opportunities, including the potential for SIBs. Advanced preparation, particularly around data, is necessary to prepare for these opportunities. The recommendations listed above build the City's PFS capacity. Departments will continue to monitor and look for opportunities within existing resources. However, to create a dedicated effort to formally move ahead with SIB research and possible implementation, hiring outside consultants would be necessary. The cost of a Transaction Coordinator is approximately \$300,000 to \$500,000, and the evaluation cost for SIBs is approximately \$500,000 to \$750,000. Often, these costs are not all borne by the government jurisdiction as some of these costs have been funded by foundations that are working in specific areas.

If you have any questions regarding this matter, please contact me at (562) 570-4016.

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