Statement of

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on

Social Impact Bonds

Committee of the Whole
Council of the District of Columbia

June 6, 2013

Kelly A. Walsh is a Research Associate at the Urban Institute. John K. Roman is a Senior Fellow at the Urban Institute. They are indebted to Sam Bieler, Sam Taxy, Akiva Lieberman, and Nancy La Vigne for past and current work on social innovations, including social impact bonds. All opinions expressed herein are solely the authors’ and should not be attributed to any of these individuals or any organizations with which Roman and Walsh are associated.
Mr. Chairman and members of the Committee:

Thank you for the opportunity to testify before you on B20-125 and to discuss the potential for social impact bonds to benefit the citizens of the District of Columbia. While the social impact bond concept is new and relatively untested, it has great potential to improve service capacity for a broad range of programming that will continue to benefit the District long after the original social impact bonds are completed.

The social safety net’s deficiencies stem from the tension between providing as many services as the District can and taxing at a rate that stifles growth. Social impact bonds, or SIBs, can ease that tension. These bonds infuse private capital into resource-deprived sectors to create a social service infrastructure that reduces the harms experienced by those in crisis and simultaneously reducing their burden on the state. The goal is not to replace the public sector, but rather build a better safety net and better utilize private funds for public good.

The social impact bond concept is straightforward: inject private-sector capital into traditionally public-sector activities, producing more cost-effective practices in both sectors. Private investors put up capital to fund interventions that are too big or too risky for the public sector. The service providers are paid with the invested private funds. Performance targets are established, and if met, investors are rewarded with profits. If the performance targets are not met, the government does not have to pay for the services delivered. The best candidates for private funding are programs with large up-front costs, programs that serve large numbers of people, and programs with a strong evidence base.

This big idea was first tested in Peterborough Prison in the UK, where it began two years ago and is ongoing. The US Department of Justice funded three SIB-related projects last fall, including the project that we work on at the Urban Institute to create a blueprint for social impact bonds in America. The US Department of Labor is evaluating state and local proposals to implement social service programs funded by SIBs and has committed up to $20 million to these projects. New York state and Massachusetts, among others, have issued SIB solicitations. Numerous investment banks, venture capital firms, and philanthropies have indicated a strong interest in participating in these projects.

In New York City, Goldman Sachs, in partnership with the Bloomberg Foundation, has invested $9.6 million in a program to help thousands of young men in the jail at Rikers Island learn skills that research says will keep many of them out of jail in the future. An independent, rigorous evaluation is being used to measure the program’s success. If the rate at which these young men recidivate meets performance targets (which would be 10 percent below typical recidivism rates), then Goldman Sachs will have its principal returned and receive up to $2.1 million in profit from New York City. If not, the government pays nothing but still benefits from having received those services.

The appeal of SIBs is that everybody could win. Philanthropically oriented investors get a chance to leverage their gifts with the potential to receive a profit, allowing them to reinvest those same dollars in another worthy cause. If investors do not earn a profit, they still accomplish their initial goal of making a socially beneficial investment. The government gets private-sector investment for an intervention that would otherwise have been left untested, to the potential detriment of society. If the services are
effective and successful, the government gladly pays for them. If they’re not, public dollars can be reallocated to something else or returned to taxpayers.

Through our work funded by the US Department of Justice, we have identified nine steps to successfully implement a social impact bond. First, a state must identify the users of government services and drivers of cost. Second, identify the gaps that cause those people to need those services and associated spending. Third, find evidence-based solutions to those problems. Fourth, assess those programs to determine if a SIB is suitable. Fifth, price the transaction and set performance targets based on outcomes. Sixth, develop the deal between the government, the service provider and the private investor. Seventh, create the infrastructure necessary to implement new services. Eighth, deliver service with training and technical assistance to ensure fidelity to evidence-based best practice. And finally, conduct an independent outside evaluation to determine if the performance goals were met and the investor will be repaid.

The District faces many daunting social welfare challenges. Many of these problems are at a scale that is beyond the ability of government to address alone. The social impact bonds method of integrating private capital into traditionally public-sector activities shows great promise. By focusing in particular on prevention, SIBs have the promise of dramatically reducing future costs of remediation.

However, in our opinion, Bill B20-125 is insufficient to support social impact bonds in the District. The bill language is more suited to performance-based contracting, not a social impact bond mechanism. The primary difference between the two is that with performance-based contracting, the service provider is not paid unless output goals are reached (e.g., 100 incarcerated juveniles received case management services), in the social impact bond model, the private investor is not repaid unless outcome goals are reached (e.g. juvenile recidivism is reduced by 10 percent in 5 years). In the SIB model, the service provider payment is not linked to performance, repayment to the investor is.

This innovative financing tool is flexible enough to allow for custom designs in each state, however, there are some additional components necessary. SIBs must include outside private investment, a financial intermediary, and an outside independent evaluator to determine if goals were met. Only the last of these components are included in the current bill. In our written testimony, we respectfully offer specific bill language that would address these concerns.

Thank you for the opportunity to testify today and we would be happy to answer questions.

Comments on B20-125

These comments are respectfully submitted with the acknowledgment that our expertise is in social impact bond mechanisms, not District law or legislation.

Pg. 2, lines 8–11 “(l) The procurement of services is for education or special education, health, human care, or social services to be provided directly to the disabled, disadvantaged, displaced,
The conditions on pg. 2, lines 8–11 may be too exclusive. It does not include place-based issues like blight remediation or violence reduction.

Pg. 2, lines 13–14 “(2) The services being procured are services that are intended to mitigate and reduce specific social and health related problems in the District;”

Restricting the services procured to social and health-related problems excludes infrastructure improvements that may be good candidates for a SIB funding model.

Pg. 2, lines 16–19 “(3) The procurement is for one or more services that an agency typically purchases as needs arise, but for which the quantity, rate of utilization, delivery areas, or specific beneficiaries of the services cannot be accurately estimated at the outset of the procurement process.”

SIBs are ideal to fund programs that a government wants but are too risky to procure. This language could exclude SIB funding for services that an agency desires but does not typically purchase.

Pg. 2, lines 32–34, preceded by line 25: “(b) A social impact bond contract shall include:” “(3) A schedule that indicates the amount and frequency of payments that would be earned by the provider of services during each year of the agreement if performance targets are achieved as determined by the independent evaluator;

This language describes pay-for-performance contracting, not a SIB contract. In the SIB model, the service provider is paid with the private funds invested. If the program targets are met, the government repays the investor plus interest.

Pg. 2, lines 41–42: “(c) The funds for social impact bonds shall be made available from the same funding source that an agency would otherwise use to procure such services.”

This language places an unnecessary limit on the source of SIB funds. In the SIB model, funds from the investor pay the service providers, and funds from the government are theoretically accrued from the savings achieved by successfully reaching program goals. The funds necessary to execute the contract and the independent evaluation are new SIB-related expenditures and will not have a source of precedent funding. Additionally, SIBs may be used to fund new services that do not have a traditional funding source in the District.