Special Topics Brief:

Pay for Success Financial Mechanisms

September 2015

Corporation for NATIONAL & COMMUNITY SERVICE

SOCIAL INNOVATION FUND

The mission of the Corporation for National and Community Service is to improve lives, strengthen communities, and foster civic engagement through service and volunteering. Each year, CNCS provides opportunities for more than two million Americans of all ages and backgrounds to serve their communities and country through AmeriCorps, Senior Corps, the Social Innovation Fund, and the Volunteer Generation Fund.

The Social Innovation Fund (SIF), a program of the Corporation for National and Community Service (CNCS), combines public and private resources to grow the impact of innovative, community-based solutions that have compelling evidence of improving the lives of people in low-income communities throughout the United States. The SIF invests in three priority areas: economic opportunity, healthy futures, and youth development.

Suggested Citation

Moazed, T. (2015). *Special Topics Brief: Pay for Success Financial Mechanisms*. Washington, D.C.: Abt Associates. Prepared for the Corporation for National and Community Service, Office of Research and Evaluation.

Authors

The following researchers at Abt Associates prepared this report for the Corporation for National and Community Service's Process Evaluation of the Social Innovation Fund Pay for Success program:

Tyler Moazed

1201 New York Avenue, NW
Washington, DC 20525
(202) 606-5000 | TTY: (202) 606-3472
info@cns.gov | nationalservice.gov

Table of Contents

I. Introduction

In 2010, the Corporation for National and Community Service (CNCS) launched the Social Innovation Fund (SIF), one of six federal tiered innovation and evidence initiatives that prioritize rigorous evaluation and building evidence of effectiveness. Through the SIF, CNCS augmented its existing activities with an enhanced focus on identifying and growing innovative, evidence-based approaches to challenges faced by low-income communities nationwide. The SIF provides funding to grantmaking institutions, referred to as "intermediaries," to support high-performing community-based nonprofit organizations to identify and grow promising outcomes-focused solutions that address pressing social problems in three focus areas—youth development, economic opportunity, and healthy futures. In 2014, the SIF launched an initiative to support the expansion of Pay for Success (PFS), a strategy that seeks to better connect government funding of services with real-world effects by tying funding for a service intervention to its impact in the community. Instead of paying for services regardless of their effects, governments (or other entities) pay only if programs actually achieve positive outcomes for the people they are designed to benefit. Where government employs PFS strategies, taxpayers no longer bear the risk of paying for programs that are not effective.

CNCS recognized the PFS model as an important tool to build upon the goals and success of the SIF by supporting innovation, ensuring solutions have the dollars needed to scale, and paying for results. The initiative, known as the SIF PFS program, specifically seeks to:

- Strengthen and diversify the pipeline of governments and nonprofit organizations that are prepared to engage in PFS projects,
- Assess the potential of PFS to address a variety of social issues relating to diverse populations in diverse geographic contexts, and
- Attract capital to high-performing institutions seeking to strengthen, grow, and sustain effective solutions for challenges facing low-income communities.

In its inaugural year, the SIF PFS program funded eight grantees to either conduct feasibility studies or support the structuring of transactions for PFS projects in the SIF's three focus areas.

This report was developed as part of a series of special topics briefs designed to provide practical insights on specific aspects of the PFS model and to assist stakeholders in making informed decisions as they explore and implement PFS projects across the country.[1] The focus of this brief is on the financial instruments and general accounting strategies being implemented in current, domestic PFS projects. Specifically, this report will provide real-life, concrete examples of how PFS projects across the nation store, manage, and eventually distribute capital used for PFS projects.

In the United States the PFS model is still in its infancy, with only seven PFS projects operating domestically at the time of this report.[2] And while interest in the PFS model continues to grow in the United States, many operational details underlying the design and implementation of PFS financing are still unknown.[3] To better understand the financial mechanisms utilized in PFS projects, three questions were identified for the seven existing projects with PFS financing that have been or are currently being implemented in the United States at the time of research for this report ("PFS projects"):

---

1 This document was developed by Abt Associates under contract to CNCS as part of the CNCS Process Evaluation of the Social Innovation Fund (SIF) Pay for Success Program.

2 This brief was developed prior to *Special Topics Brief: Service Provider Capacity Building for a PFS Project* and so is not inclusive of the eighth project reviewed for that report. Additionally, these seven PFS projects existed before the SIF PFS program, and have no connection to the program or CNCS. For additional information on these PFS projects please refer to CNCS's *State of the Pay for Success Field: Opportunities, Trends, and Recommendations.*

3 PFS financing refers to the capital that covers the costs of service provision until success is achieved and payments are triggered. PFS financing is sometimes referred to as a Social Impact Bond (SIB).

1. Where does the money allocated for repayment reside during the length of the PFS project during implementation?
2. How is the upfront capital managed, and how does it flow during service implementation/project operation?[4]
3. What are the prices per outcome and the repayment structures for PFS projects?

In order to provide answers to these questions, representatives from the seven PFS projects, were contacted via email and phone calls during the summer of 2015. Exhibit 1 provides a list of the PFS projects contacted and the organizational affiliation and roles of the organizations that provided responses.

The remainder of this document presents the responses of project representatives to the three financing questions and provides a brief analysis of the similarities and differences in strategies and structures across the seven PFS projects. Please note that all but one of these projects are still active. Therefore, due to certain contractual limitations and the involvement of proprietary information associated with the financial aspects of these projects, there is some variation across responses in terms of the level of detail provided. Despite these limitations, every attempt was made to provide as much relevant information as possible.

Exhibit 1. Affiliations of Interviewees for this Report

Pay for Success Project (chronologically listed)	Organization	Role
New York City ABLE Project for Incarcerated Youth	MDRC New York City Mayor's Office	Intermediary Government Agency/ Outcomes Payor
New York Increasing Employment and Improving Public Safety PFS Project	Social Finance US	Intermediary
	New York State Department of Labor	Government Agency/ Outcomes Payor
Massachusetts Juvenile Justice PFS Initiative	Third Sector Capital Partners Massachusetts Executive Office of Administration and Finance	Intermediary Government Agency/ Outcomes Payor
Utah Pre-K PFS Project	United Way of Salt Lake	Intermediary
	Voices for Utah Children	Project Coordinator[5]
Cuyahoga County (OH) Partnering for Family Success Program	Cuyahoga County Health and Human Services (OH)	Government Agency/ Outcomes Payor
Chicago Child-Parent Center PFS Initiative	Illinois Facility Fund	Project Coordinator
Massachusetts Chronic Homelessness PFS Project	Massachusetts Executive Office of Administration and Finance	Government Agency/ Outcomes Payor
	United Way of Massachusetts Bay and Merrimack Valley	Fiscal Manager

4 Upfront capital refers to funding for services and intermediary and/or evaluator fees.

5 Within the PFS field the terms "intermediary" and "project coordinator" are often used interchangeably, but they represent specific roles in the Utah and Chicago PFS projects. In the Utah PFS project, the intermediary, United Way of Salt Lake, is responsible for overseeing the implementation of the project including contracting, reporting, and repayments to service providers. The project coordinator, Voices for Utah Children, helped design the repayment structure and provides financial structuring, research, and analytic support. Alternatively, in Chicago the project coordinator, the Illinois Facility Fund, is responsible for managing the flow of capital between funders and Chicago Public Schools, distributing loan dollars for PFS operations, and repaying lenders based on program outcomes. The intermediary in the Chicago PFS project, Metropolitan Family Services, assists exclusively on the services side of the project by identifying best practices and possible sites for expansion.

II. Question 1: Where does the money allocated for repayment reside during the length of the PFS project during implementation?

At its core, the PFS model involves government (or some other outcomes payor) paying for outcomes achieved by a service provider only after services have been provided and outcomes have been achieved at pre-set target levels. In a PFS project, the actual implementation of the service intervention is frequently financed through private investors. While this concept is straightforward and commonly understood among stakeholders engaged in a PFS project, the details underlying how governments or other outcomes payors allocate and "protect" the funding until it is needed are often overlooked by stakeholders new to the field. Exhibit 2 provides responses to this key question from representatives of the seven PFS projects in the U.S. to date.

Exhibit 2. Responses to Question 1

Pay for Success Project	Where does the money allocated for repayment reside during the length of the PFS project during implementation?
New York City ABLE Project for Incarcerated Youth	New York City entered into a direct contract with the PFS project intermediary, MDRC, to pay for the outcomes associated with the PFS project. According to the New York City Mayor's Office, the Mayor takes very seriously the risk of negatively impacting the City's credit rating if requested payments are not made. Therefore, when/if repayments are due, the City of New York plans to add a "new needs" item to the New York City Department of Corrections annual budget or "self-fund" the payments using available funds in the Department's current budget.
New York Increasing Employment and Improving Public Safety PFS Project	To ensure sufficient funding is available over the life of the project for outcome payments, New York State annually appropriates funds for this project until the outcome payments are potentially due. The annual appropriation is accounted for in the New York State Budget in the Aid to Localities Federal Workforce Investment Act (WIA) account of the Federal Emergency Employment Fund. The New York State Division of the Budget requires the New York State Department of Labor (NYSDOL) to segregate PFS monies appropriated in that account separately from other federal grants. This enables the NYSDOL and the state to control PFS funds for their intended purpose, and prevents them from being used for other budgetary purposes.
Massachusetts Juvenile Justice PFS Initiative	In 2012, the Massachusetts Legislature authorized the Secretary of Administration and Finance to enter into up to $50 million in Social Innovation Financing (i.e., PFS) contracts, backed by the full faith and credit of the Commonwealth. This statute also created the Social Innovation Financing Trust Fund ("Trust") to house and protect outcome payments for PFS projects. Every year, the Secretary of the Executive Office of Administration and Finance requests an appropriation equal to the expected future payments for all PFS services provided that year. Funding for the state's various PFS initiatives is all housed in the Trust and is not separated.
Utah Pre-K PFS Project	For cohort 1, repayment funding comes from the United Way of Salt Lake and from Salt Lake County (not the state) and was placed in a special fund created and managed by a local foundation, the Park City Community Foundation. By the time the second cohort began, the Utah Legislature enacted HB96, the Utah School Readiness Initiative. Among other things, the bill established the School Readiness Board (the "Board"). Contingent on the annual allocation of State funds for this purpose, the bill allowed the Board to enter into results-based financing contracts with private investors on behalf of the State, and created the School Readiness Restricted Account to house outcome funding for PFS projects. Initially allocated at $3 million, this funding along with future allocations in this account can be used to repay investors based on results of the project, as well as provide grants for quality improvement.
Cuyahoga County Partnering for Family Success Program	Cuyahoga County created the Social Impact Financing (SIF) Fund for the project to manage the unique nature of PFS contracts. The funds in the SIF Fund are certified and encumbered for the Partnering for Family Success project. Beginning in 2014, and continuing for the next 4 years, $1 million annually is budgeted for this fund, per Council ordinance, totaling $5 million in funding. The County created guidelines for the fund that include contractual language that requires a certification and encumbrance for the project to continue, as well as a stipulation that the project would wind down if the allocation did not occur or there was a reallocation of the funds that were already in place.

Pay for Success Project	Where does the money allocated for repayment reside during the length of the PFS project during implementation?
Chicago Child-Parent Center PFS Initiative	There are two outcome payors in Chicago (the City of Chicago and the Chicago Public Schools), and each is handling its funding obligations differently. The City of Chicago created a special escrow account called the City PFS Escrow Account, and money is placed in the account annually based on base case expectations for the number of students in that year's cohort. The base case estimate is for two of the three outcome measures (Kindergarten Readiness and Third Grade Reading). The first deposit into the escrow account by the City of Chicago occurred at the time of the deal's initial closing around November or December 2015. All future deposits will occur on August 15th of each year. Due to legal reasons, Chicago Public Schools was not able to create an escrow account, so it uses its annual budget process to secure PFS project funding. Each year, Chicago Public Schools appropriates funding to cover PFS costs related to 1) the actual cost of the services to the expanded cohorts and 2) the projected "base estimate" payments for the special education services outcome. Unlike the City of Chicago, which deposits money annually based on the size of the cohort, Chicago Public Schools budgets for the payments it expects to make that year.
Massachusetts Chronic Homelessness PFS Project	See Massachusetts Juvenile Justice PFS Initiative above.

As indicated in Exhibit 2, four of the PFS projects involved some type of legislative initiative or new government-sponsored financial instrument, such as an escrow account, to house and protect outcome payor funds until it is time to repay investors. The two Massachusetts projects, the Utah project, and the Cuyahoga County project enacted legislation that explicitly allowed the local or state government to engage in PFS financing, while creating a special fund specifically for that purpose. While no legislation was passed for the Chicago PFS project, the City created a PFS-specific escrow account, similar to the projects in Massachusetts, Utah, and Cuyahoga County.

The two PFS projects in New York took a slightly different approach to financing. Representatives from the NYC ABLE project, the first domestic PFS project, emphasized that a key goal when designing their PFS project was to make the financing structure as simple as possible. The New York City Mayor's Office felt strongly that it could use the standard budget allocation process to fund repayment when it was time for outcome payments to be distributed. The New York State PFS project also relied on the budgetary process for allocating PFS money, but instead of simply expecting money to be available at the time of repayment, it created a system where the New York State Department of Labor could segregate PFS monies appropriated in that account separately from other federal grants. Ultimately, both projects relied on state/local legislatures to allocate funding accordingly, knowing that while there was no legislative requirement, a failure to properly repay investors based on outcomes achieved would negatively impact the credit standing of the governments involved.

Key themes/findings from question 1:

- Unique, PFS-specific, escrow accounts are often used to house funding for outcome payments.
- Failure to sufficiently appropriate funds may adversely impact credit ratings of government/outcomes payors.
- Legislative authorization is frequently needed to establish a structure for outcomes payments.

III. Question 2: How is the upfront capital managed, and how does it flow during service implementation/project operation?

Due to the complex nature of PFS financing, paying for project services and other operational costs is often not as straightforward as funding service interventions in traditional ways. Therefore, governments and intermediaries have developed innovative ways to collect funds and manage operational costs during the length of a PFS project. Exhibit 3 provides information on how the seven PFS projects collect, manage, and distribute private funding to implement services and fund program operations.

Exhibit 3. Responses to Question 2

Pay for Success Project	How is the operating capital managed and how does it flow during service implementation/operation?
The New York City ABLE Project for Incarcerated Youth	MDRC managed the program's operations through an interest-bearing loan from Goldman Sachs Bank USA. The loan was used to cover expenses incurred by Osborne Associates and Friends of the Island (service providers) in delivering the service intervention. MDRC also entered into a contract with the Department of Corrections of New York City (DOC), which would have made outcomes payments to MDRC for all or a portion of the costs of the program, if target reductions in recidivism were achieved. DOC was also obligated to make additional outcomes payments if the target percentage of reductions in recidivism was exceeded. Payments from DOC to MDRC would have been used to pay back the loan from Goldman Sachs along with an additional performance fee for exceeding outcome targets.
New York Increasing Employment and Improving Public Safety Pay for Success Project	Capital is requested from the contracted investors twice, half at the beginning of the PFS project and half at the start of the second phase. Funds from the investors are placed in an account managed by the "managing member," Social Finance US, using a Special Purpose Vehicle (SPV) created for the project, and are disbursed based on a contractual agreement. Funding for the service provider, Center for Employment Opportunity (CEO), is provided on a quarterly basis in advance of expected services provided. Social Finance receives reports from CEO on key metrics to ensure appropriate use of funds.
Massachusetts Juvenile Justice PFS Initiative	The intermediary, Third Sector Capital Partners, created Youth Services, Inc. (YSI) a supporting 509(a) (3) organization of Third Sector, as a Special Purpose Vehicle (SPV) that controls the funding in the PFS project. YSI receives quarterly funding draws from the private lenders and yearly draws from the philanthropic investors. The funding amount provided to the service provider is based on the number of project participants receiving services. These funding draws are used by YSI to cover project costs such as service fees from the service provider, evaluation service fees, fiscal agent fees, and project management costs.
Utah Pre-K PFS Project	The operating capital is managed by the intermediary, United Way of Salt Lake (UWSL). At the beginning of the project, J.B. Pritzker and Goldman Sachs agreed to loan up to $7 million to UWSL to cover high-quality pre-school education for up to five cohorts of participants. The loan payments are made in quarterly advances and held in UWSL's primary deposit account until service provider payments are made. Money is then distributed to providers monthly, starting at the beginning of the school year. The amount funded to each provider is based on the number of participants it will serve.
Cuyahoga County Partnering for Family Success Program	As part of the PFS contract, the intermediary, Enterprise Community Partners, Inc., established a Special Purpose Vehicle (SPV), Cuyahoga PFS, LLC, that houses the Partnering for Family Success operating account. PFS investors wire their investments into the SPV operating account based on a funder drawdown schedule that was established as part of contract negotiations. The schedule is broken down by quarter, with the first disbursements made in Q1 through final disbursement in Q9. The intermediary is also responsible for ensuring the SPV provides the PFS Governance Committee with the operating account's quarterly financial statements and to ensure investors are making their payments based on the agreed-upon schedule. All project operations are paid through the SPV on different schedules: • Evaluator (Case Western Reserve University): Monthly • Service Provider (Frontline Services Inc.): Quarterly (beginning of quarter) • Project Manager (Enterprise Community Partners, Inc.): Quarterly (end of quarter) • Fiscal Agent (Enterprise Community Partners, Inc.): Quarterly (end of quarter) • Outside Auditor (through Enterprise Community Partners, Inc.): Quarterly (end of quarter) • PFS Advisor (Third Sector Capital Partners): One-time payment in Year 1
Chicago Child-Parent Center Pay for Success Initiative/SIB	The project coordinator, the Illinois Facility Fund, created IFF LLC to act as a borrower of investor funding and as the manager of the PFS funds during project operations. IFF LLC receives the money loaned from investors and then loans the money to the City of Chicago, which uses an inter-government agreement to loan the money to Chicago Public Schools for program operations. (Chicago Public Schools cannot directly loan the money from IFF LLC, so an inter-government agreement must be used.) The loan request from the City of Chicago/Chicago Public Schools is made twice a year, in early September and early January (following the semester schedule). The loan request is in the amount of the expected operating costs needed for each cohort that semester. IFF LLC was not designed as a funding warehouse, so the pass-through loan from investors through IFF LLC to the City of Chicago/Chicago Public Schools takes place in a single day. In addition to the City of Chicago/Chicago Public Schools, there are also three other organizations paid as part of the PFS project. IFF itself receives an annual fee for project coordination costs, payment for which comes from the IFF LLC investor funds. SRI International serves as the evaluator whose first-year costs are covered via a grant from the Finnegan Foundation. The project is currently exploring philanthropic and other alternative funding options for years two and three. Metropolitan Family Services provides technical assistance and wraparound services to project participants. Its first-year costs were covered through investor funds, and the project is currently exploring philanthropic investment opportunities for years two and three.

Pay for Success Project	How is the operating capital managed and how does it flow during service implementation/operation?
Massachusetts Chronic Homelessness PFS Project	At the beginning of the project, 100 percent of all investments were placed in a special LLC called the Massachusetts Alliance for Supportive Housing. When a participant is placed in a housing unit, the provider submits an invoice for a housing voucher to the fiscal agent, the United Way of Massachusetts Bay and Merrimack Valley, monthly. There are four organizations involved in this PFS project who also receive funding from the LLC. The evaluator, who is responsible for verifying placement in supportive housing, submits monthly invoices. The fiscal manager, the program administrator, and the advisor all have contracts for the length of the project and are paid quarterly from the LLC.

As indicated in Exhibit 3, five of the seven PFS projects in operation used either a Limited Liability Corporation (LLC) or some other type of special purpose vehicle (SPV) a to house and manage the funds during program operations. LLCs and other types of SPVs serve a similar purpose for the intermediary, which is to protect the organization by isolating financial risk inherent in receiving a loan from the investors. The rationale was that if problems occur with services, such as not recruiting enough participants, or with outcomes payments, the intermediary would not want to bear the burden of defaulting on a loan or declaring bankruptcy.

PFS projects utilized a variety of draw-down strategies to pay for service interventions advanced through PFS projects. Three of the projects, the Massachusetts Juvenile Justice, New York State, and Cuyahoga County PFS projects, made quarterly disbursements to the service providers and other contracted partners. The involvement of public school districts and the provision of services within schools for the PFS projects in Utah and Chicago pushed them to create a funding assessment and disbursement plan that followed a semester-based academic calendar, with service providers paid before the start of the fall and/or spring semesters. In the Massachusetts homelessness project, because a large portion of investor funding is going to housing vouchers, the project did not need access to recurring drawdown funds. Instead, the intermediary received invoices for the housing costs of each individual placed in supportive housing.

The proprietary nature of the New York City ABLE project prevented those involved from providing specific information about management and disbursement of investor funding.

Key findings/themes:

- The majority of PFS projects developed an LLC or SPV to help protect intermediary organizations (or any organization managing PFS financing) from financial risks associated with PFS financing.
- The two PFS projects that did not establish an LLC or SPV both had loan arrangements with a very small number of investors (one or two) and wanted to keep the financial arrangements simple and straightforward.
- Operating capital is typically drawn down annually or quarterly (i.e. withdrawn from the LLC/SPV), while the disbursement of the funds is often based on the structure of the services being provided (i.e., rolling service enrollment vs. academic calendar based enrollments).

IV. Question 3: What are the prices per outcome and the repayment structures for PFS projects?

How key outcomes are valued and packaged as metrics for repayment to investors is by far the most complex of the three topic areas explored in this topic brief. Pricing outcomes and negotiating returns on investment (ROI) can be a very delicate process, where those involved need to balance project savings with service intervention risk and make it acceptable to investors, policy makers, and the community. Often, the final determinations around outcome metrics and repayment levels are based on the government or the outcomes payor’s “willingness to pay” for the desired outcomes. The purpose of this question was not to explore the details of how theoretical savings and due-diligence resulted in these repayment structures, but instead to provide an overview of what types of outcomes are being targeted, what value those outcomes have for specific PFS projects, and how investors are repaid from those values.

New York City ABLE Project for Incarcerated Youth

The target outcome for the NYC ABLE PFS project was recidivism, with a goal of reducing recidivism among the target population by 10 percent. The maximum amount of outcomes payments was $11.7 million, and payments were graduated based on the average percentage decline in recidivism rates after three years of operation and one year of follow-up, as demonstrated below. It is important to note that repayments from NYC were channeled through the project intermediary, MDRC.

Exhibit 4. New York City ABLE Project Repayment Structure

Percentage Reduction in Reincarceration Rate	City Payment to MDRC ($)
≥ 20.0	$11,712,000
≥ 16.0	$10,944,000
≥ 13.0	$10,368,000
≥ 12.5	$10,272,000
≥ 12.0	$10,176,000
≥ 11.0	$10,080,000
≥ 10.0 (breakeven)	$9,600,000
≥ 8.5	$4,800,000

New York Increasing Employment and Improving Public Safety Pay for Success Project

There are three outcome targets in this PFS project: 1) recidivism reductions (in the form of bed-days avoided over a five-year period); 2) employment (achievement of positive earnings in the fourth quarter after exit from incarceration); and 3) number of treatment group members participating in transitional employment arranged by the service provider. The primary repayment outcome is recidivism, which has a repayment formula based on the estimated averages savings and community benefit of avoiding a single bed-day. This PFS project is broken into two phases, with each phase having slightly different repayment amounts ($85 in Phase 1 and $90.10 in Phase 2 for each bed day). Each repayment measure and phase is also capped to ensure the state does not overpay and lose money on the project. The performance thresholds and repayment structure for the three metrics are in the tables below.

Exhibit 5. New York Increasing Employment and Improving Public Safety Project Repayment Structure

Performance Threshold	Repayment Formula	
	Phase 1	Phase 2
Outcome 1: Recidivism		
At least an eight percent average reduction in bed days (estimated to be 36.8 bed days) for treatment group members relative to the control group	Average reduction in bed days x $85 x number of participants up to $6,832,000 (then $42.50 per bed-day avoided up to $11,095,000)	Average reduction in bed days x $90.10 x number of participants up to $6,668,000 (then $45.05 per bed-day avoided up to $10,448,853
Outcome 2: Employment		
At least a five percentage point difference in employment rate for treatment group members relative to the control group	Percentage point difference in employment rates x $6,000 x number of participants (up to $2,000,000)	Percentage point difference in employment rates x $6,360 x number of participants (up to $2,000,000)

<table>
<tr><th rowspan="2">Performance Threshold</th><th colspan="2">Repayment Formula</th></tr>
<tr><th>Phase 1</th><th>Phase 2</th></tr>
<tr><td colspan="3">Outcome 3: Transitional Employment</td></tr>
<tr><td rowspan="2">Number of participants engaged in transitional jobs (no threshold or comparison)</td><td>Number of participants engaged in transitional jobs x $3,120
(If average hours worked is equal to or over 111)</td><td>Number of participants engaged in transitional jobs x $3,307
(If average hours worked is equal to or over 111)</td></tr>
<tr><td>Number of participants engaged in transitional jobs x average hours worked x $20 per hour
(If average hours worked is under 111)</td><td>Number of participants engaged in transitional jobs x average hours worked x $21.20 per hour
(If average hours worked is under 111)</td></tr>
</table>

Massachusetts Juvenile Justice PFS Initiative

The three target outcomes in this project include: 1) recidivism reductions (in the form of bed-days avoided); 2) employment (based on the percentage of quarters an individual has with earnings more than $1,000); and 3) youth worker engagement (nine or more engagements with a service provider staff person within a quarter). For the recidivism metric, the Massachusetts Juvenile Justice PFS Initiative utilized a tiered outcome/repayment model to help place emphasis on meeting outcome targets that utilize the most monetary savings. The repayment thresholds and amounts for the three metrics are below.

Exhibit 6. Massachusetts Juvenile Justice Project Repayment Structure

Outcome 1: Recidivism

	No Impact	Low impact	Medium impact	High impact	Maximum
Performance Thresholds	Less than 5% reduction in bed days	5% – 14% reduction (29 – 87 bed days)	15% – 42% reduction (88 – 243 bed days)	43% – 66% reduction (244 – 358 bed days)	67% or more reduction (359 or more bed days)
Repayment Amount (per person served)	No Payment	$785 – $3,975	$4,016 – $26,491	$26,639 – $28,463	$28,540

Outcome 2: Employment

	No Impact	Impact
Performance Thresholds	Less than 5 percentage point difference in “person quarters” of employment	At least 5 percentage point difference in “person quarters” of employment
Repayment Formula	No Payment	Total quarters observed for treatment group x percentage point difference between treatment and control group x $750, up to $1.6 million

Outcome 3: Youth Worker Engagement Calculations

	No Impact	Impact
Performance Thresholds	Fewer than 9 meetings between a treatment group member and a Roca Youth Worker	9 or more meetings between a treatment group member and a Roca Youth Worker
Repayment Formula	No Payment	Impact

Utah Pre-K PFS Project

There is one outcome measure for this project—usage of special education services in kindergarten through sixth grade. Each cohort of three- to four-year-olds is given the Peabody Picture Vocabulary Test (PPVT), a predictive assessment that serves as an indicator of the likelihood of later need for special education and remedial services. Students who test two or more standard deviations below the mean at preschool entry form the “payment cohort” and are followed in K-6 to determine outcome payments. For each year (from kindergarten through sixth grade) a child in in the “payment cohort” does not utilize special education, a success payment is made equal to 95 percent of the avoided costs per-pupil costs (approximately $2,600 for

Cohort 1 and approximately $2,700 for Cohort 2), or approximately $2,470 (Cohort 1) and $2,565 (Cohort 2) per child for every year. For the first cohort, the cap on return is the full amount of investment plus a base interest rate of 5 percent. If this cap is reached before the cohort completes sixth grade, success payments will equal 40 percent of Cohort 1 costs ($2,600) or $1,040 per child per year of special education services avoided through sixth grade. For the second cohort, the investors will be repaid up to a maximum interest rate of the Municipal Market Data General Obligation Bond AAA scale for a ten-year maturity at the time of issuance plus 5 percent. Outcomes for each cohort are calculated in the summer, and repayments are made to investors each August.

Cuyahoga County Partnering for Family Success Program

The sole outcome metric for this project is a reduction in the number of out-of-home foster care (OHF) days for children. For each OHF day reduced for participating children relative to the control group, Cuyahoga County will pay $75, which represents the combined average cost of foster care and related social services per child, per day. The target impact for the project is a 25 percent reduction in OHF days for treatment group participants. Below is a table with the breakdown of outcome payments by percentage reductions in OHF days.

Exhibit 7. Cuyahoga County Partnering for Family Success Program Repayment Structure

Percent Reduction in OHF Days	Success Payments Paid by Cuyahoga County
40%	$5.0 million
30%	$4.55 million
25%	$4.125 million
20%	$3.4 million
10%	$1.7 million

Chicago Child-Parent Center Pay for Success Initiative/SIB

There are three outcome metrics for this project: 1) kindergarten readiness; 2) special education usage; and 3) third grade reading level. For every participating student who is “school ready” for kindergarten, investors will be repaid $2,900. For each participant who does not need special education services, investors will be repaid $9,100 per student, per year, with a one percent compounded interest rate per student. Finally, if there is an increase in third grade literacy, investors will receive $750 per student who tests above the national literacy average.

Massachusetts Chronic Homelessness PFS Project

The target outcome metric for this project is stable housing. Investors are paid $3,000 for every year that an individual is in stable housing during the project, up to a total of $6 million dollars. The contract's target success level is 85 percent of participants successfully housed for one year or more. Below is a table with a sample of the breakdown of return on investment by the percentage of participants successfully housed for one year or more.

Exhibit 8. Massachusetts Chronic Homelessness Project Repayment Structure

Participants in Stable Housing for at Least One Year	Return on Investment
94% or more	5.33%
91%	4.66%
85%	3.33%
79%	0%
Below 79%	Begin Losing Principal Investment

Unlike the first two questions explored in this topic brief, where there were some commonalities among responses, the outcome metrics and repayment structures reported by project representatives varied extensively across the seven PFS projects. While there were common areas of focus (e.g., recidivism, employment) and measures (e.g., bed-days, wage increases), the actual prices and payment thresholds were very diverse. For example, four of the seven PFS projects focused on just a single outcome metric (New York City, Utah, Cuyahoga County and Massachusetts [homelessness] projects). In all four cases, the projects tended to be smaller in size and scope and had very targeted savings areas. Representatives from these projects emphasized the importance of trying to make these aspects of the projects as simple and straightforward as possible. Chicago, New York State, and the Massachusetts Juvenile Justice project all had three outcome measures. While Chicago had three outcome measures, they are all education focused and interconnected. The general thinking behind Chicago's outcome and repayment model is that improved kindergarten readiness (measure 1) will lead to reductions in special education resources (measure 2), which will ultimately result in better third grade reading levels (measure 3). So while there are three distinct outcome measures, there is a strong correlation and progression between them.

Only the New York State and Massachusetts Juvenile Justice PFS projects had three distinct outcome and repayment metrics. In both cases, the focal measure is recidivism, as both projects identified that outcome as the biggest source of government fiscal and societal benefit. While the employment metric also provides savings in the form of increased tax revenue and reduced dependence on supportive services, the potential savings are not nearly as large as those achieved through recidivism reduction outcomes. US Department of Labor (USDOL)'s requirement for projects to target employment and include that measure in the repayment structure is a key factor in both projects.[6] Finally, both projects also included a third payment metric directly related to the service model. These two projects are significantly larger, longer, and more expensive than any of the other PFS projects. As a result, both projects wanted measures that would both acknowledge successful implementation of the services and serve as an indicator for success for the other two measures.

Key findings/themes:

- The outcome metrics and repayment structures varied extensively across the seven PFS projects depending upon their focus and size.
- Smaller PFS projects focused on a single outcome measure for repayment to help simplify the PFS financing while the two largest projects identified three outcome measures each.
- Savings and outcome payment calculations are complex and frequently involve the use of outside advisors to help in their construction.

V. Conclusion

Despite the diversity of projects and complexities inherent in these financial questions, some key findings and lessons can be found across the seven PFS projects and in response to the questions driving this inquiry. In addition, new areas of inquiry emerged as potential future research topics. We begin with the three key findings:

1. **Legislative initiatives can help position local/state governments to engage in PFS projects, but they are not a requirement.** While most of the PFS projects that were surveyed enacted legislation to better position the government to engage in PFS projects and protect back-end funding, it was not always a necessity. Multiple governments were able to implement PFS projects without any legislative changes.
2. **Intermediaries (or similar organizations who manage PFS projects during implementation) frequently create special purpose vehicles (SPV) or limited liability companies (LLCs) to manage investor funding during project**

[6] USDOL committed funds to New York State and Massachusetts for outcomes payments for a portion of the New York Increasing Employment and Improving Public Safety PFS project and the Massachusetts Juvenile Justice PFS Initiative.

operations. The majority of PFS projects have SPVs or LLCs to house and distribute investor funding as a way to protect the larger organizations from any potential negative consequences of unsuccessful PFS projects. As with any service intervention, there are a variety of risks that threaten the success of these PFS projects, but unlike traditional service projects, there can be hazardous financial repercussions that must be addressed in order for a PFS project to successfully begin. If the PFS model is to continue to grow domestically, intermediaries may well need to implement strategies that protect their larger organizations from long-term negative consequences.

3. **Calculations of savings and outcome payments are extremely complex and vary dramatically across projects and policy areas**. Across the three financial mechanism questions, the structures of outcome payments provided the most variety among the projects surveyed. Since these payments are so closely tied to projected savings, the way in which local or state governments price various aspects of savings and benefits will change. Regardless, this aspect is extremely complicated and requires the involvement of highly skilled and experienced staff.

While the seven PFS projects featured in this brief provide useful information about the financial mechanisms involved with non-federal PFS projects, there is still a lot to be learned. As frequently noted within this Special Topic Brief, the financial structures and instruments involved with non-federal PFS are very complicated and the emergent nature of the field means there is no definitive, evidenced-based approach to PFS financing. At the same time, in helping to answer these three questions, a number of other related areas of inquiry emerged that could also prove beneficial to those exploring PFS projects. Potential future research questions include:

- What is the nature and structure of the fees collected by intermediaries (or similar organizations)? What is included in these fees, and what type of variation is seen across the active PFS projects?
- What is the motivation for intermediaries to become involved with PFS projects? What do these organizations see as the potential benefits of their involvement, especially in light of the inherent risks associated with any PFS project?
- For projects that involve Federal monies allocated for PFS projects, what happens if the project does not produce the intended outcomes? Can monies be repurposed or will the money go back to the Treasury?
- What types of financial instruments are being used to collect investor funding (e.g., loans, grants, private-placement offerings[7]), and what are the various pros and cons of each tool?
- What is the impact of service providers having a financial stake in the success of PFS projects? Is there any difference in program operations or service outcomes when a service provider has portion of its their fee/costs tied to outcome benchmarks or when grants are awarded to service providers who achieve certain outcomes?
- How frequently are PFS outcomes and/or repayment schedules renegotiated during an active PFS project? How common are exit options for investors? What are the financial and reputational consequences for parties that exit a PFS project early?

Those interested in pursuing PFS projects have the opportunity to learn from these current projects. Although financing structures can be idiosyncratic due to differences in funders, state/local laws, and domain focus across projects, these broad lessons learned can prove to be helpful. Of course, what works and what is currently successful in the PFS field may change many times before true best practices are identified in this nascent field.

---

[7] A private placement is the sale of securities to an individual or a small group of investors. This is the counterpart to public offerings, which are sold in the open market and available to any investor.