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Social Impact Bonds

Can Private Investors Cure Society's Ills and Make a Profit?

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Abstract: A new financial tool has emerged in the U.S. that aims to use private investment to catalyze preventative social service programs, ultimately reducing the amount of taxpayer dollars allocated to remedial social service efforts. This new instrument is still in its infancy but is being tested in a number of cities and states around the U.S. and is gaining popularity internationally. This paper explores the new financial arrangement, the factors that determine success, and the challenges that have arisen so far. It identifies barriers to implementation, potential pitfalls, and possible resolutions for the future. Although new and only currently being tested, the Social Impact Bond is a promising development in the emerging "fourth sector" of the economy.

I. Introduction

The latest trend in socially responsible investing (SRI) is impact investing.[1] Whereas SRI is typically seen as an investing protocol that seeks to avoid investments that produce social or environmental harm, impact investing seeks to invest in companies, organizations, and funds that create a positive social or environmental impact in addition to a financial return.[2] One in every nine dollars under professional management in the United States (approximately $3.31 trillion) is invested using SRI metrics that consider environmental, social, and governance issues.[3] Currently impact investing represents only a small percentage

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1 Also called "social finance", "social impact investing", "blended value investing", or "impact finance." Maximilian Martin, *Making Impact Investible*, Impact Economy Working Papers Vol. 4, 3 (2013).

2 *About Impact Investing*, GLOBAL IMPACT INVESTING NETWORK, www.thegiin.org/cgi-bin/iowa/resources/about/index.html (last visited Dec. 13, 2013) ("investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return.")

3 *2012 Report on Sustainable and Responsible Investing Trends in the United States*

of all socially responsible investing, approximately $36 billion, but is growing fast.[4]

Impact investing encompasses program-related investments made by foundations, direct investments into social enterprises through debt or equity financing, and microfinance investments. Whereas economic sectors have traditionally been seen as fitting into one of three spheres– nonprofit, government, and business (or social, public, and private), impact investing is a part of the increasing activity in the "fourth sector" that uses business models to affect social good.[5] In response to increased investor demand for impact investment options, Morgan Stanley announced in November of 2013, that it was creating the Investing with Impact Platform, providing analysis and options on a range of impact investments for all kinds of investors. The company hopes to manage $10 billion in client assets invested in impact investments in the next five years.[6] A few days later, Goldman Sachs announced the creation of a $250 million social impact fund to invest in social impact opportunities including the latest impact investing tool, the Social Impact Bond (SIB).[7]

Bond is a misleading description of the innovative financial arrangement that is rapidly gaining traction across the globe. Unlike traditional bonds, SIBs do not require the government to issue debt. In fact, the government is only obligated to pay if there is measureable success. SIBs attempt to address social problems that cost the government, and taxpayers, money by attacking the problems preventatively. To do that, they need large amounts of early-stage financing, something that governments are often hard pressed to come up with. By using private investors to finance the upfront costs of social programs, and paying investors only if the program is successful, governments are able to shift the risk and the initial financial burden to the private sector. Although SIBs have a set

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Executive Summary, US SIF FOUNDATION (2012), http://www.ussif.org/files/Publications/12_Trends_Exec_Summary.pdf (last visited Apr. 20, 2014).

4 Martin, *supra* note 1, at 4–5; Impact investing in developing countries, in particular, has the potential for high investor returns. *Impact Investments: An emerging asset class*, JP MORGAN GLOBAL RESEARCH, 31–36 (Nov. 29, 2010) (detailing expected returns of current impact investments for debt and equity investments in developing countries).

5 *See, e.g.,* Heerad Sabeti, *The Emerging Fourth Sector*, ASPEN INSTITUTE, http://www.people.fas.harvard.edu/~hiscox/Sabeti.pdf (last visited Apr. 20, 2014) (discussing the emergence of organizations that span the traditional three sectors).

6 *Investing with Impact*, MORGAN STANLEY, http://www.morganstanley.com/globalcitizen/pdf/investing-with-impact.pdf?v=07112013 (last visited Apr. 20, 2014).

7 Lydia DePillis, *Goldman Sachs thinks it can make money by being a do-gooder*, THE WASHINGTON POST (Nov. 5, 2013).

timeline for "maturity" like a traditional bond and have a capped maximum return, from the investor's perspective a SIB is more akin to an equity investment because there is no guarantee of return, payment is entirely dependent on the program's success, and the investor bears the risk of failure.

Governments are often constrained from investing in preventative or innovative social service programs by existing program commitments and, in recent years, increasingly tight budgets. Budgets tend to fund the same line items year after year, and innovative programs rarely get needed funding because of the risk of failure and the public scrutiny that a failure would receive.[8] Government funded social programs often lack sophisticated performance measurement and focus on measuring the amount of service provided rather than the outcomes of that service.[9] Lacking proper funding, nonprofit service providers spend a disproportionate amount of time fundraising and grant seeking which often leads to an inability to bring programs to scale. And yet, there are many social problems that, if addressed preventatively, save the government and taxpayers money in the long run. Social Impact Bonds are an attempt to address these challenges.

II. Background

The basic idea behind the Social Impact Bond is to encourage private investors to give upfront capital to a third-party service provider to fund long-term programs that ultimately reduce costs to the government. If the program is successful, the government pays investors the original investment plus a return, if the program is unsuccessful, investors lose their investment. In theory, a successful program will save the government money above and beyond the cost of repaying investors.

A. Definition and Structure

Called Pay for Success Bonds, Social Benefit Bonds, or Social Impact Bonds, the financing arrangement is the same. The Center for American Progress describes SIBs as:

> an innovative financial arrangement between one or more government agencies and an external organization—sometimes

8 Jeffrey Liebman & Alina Sellman, *Social Impact Bonds: A Guide for State and Local Governments*, Harvard Kennedy School Publication, 6–7 (June 2013), http://hkssiblab.files.wordpress.com/2013/07/social-impact-bonds-a-guide-for-state-and-local-governments.pdf (last visited Apr. 20, 2014) (discussing barriers to government budgeting for social programs).

9 *Id.* at 6.

> called an "intermediary"— that can be either a nonprofit or for-profit entity…the government sets a specific social outcome or set of outcomes it wants achieved relative to a defined population over a given time period, and promises to pay the external organization a pre-arranged sum if and only if the organization is able to accomplish the desired outcome.[10]

Social Impact Bonds are considered one financing option for pay for success programs. What is so innovative about the financing arrangement is that it creates a multi-stakeholder public-private partnership by bringing together government, nonprofits and other non-governmental organizations, and private investors to tackle social issues preventatively. Social Impact Bonds are one of many new innovations that use a business-like approach to tackle societal problems.[11]

In terms of risk, SIBs are a high-risk investment although most SIBs implemented to date have been guaranteed in part by philanthropic foundations. Investors "buy-in" to the program and only get a return on their investment if the program is successful, much like buying stock in a company. In reality, SIBs are a complex set of contracts between the various actors. The programs have established benchmarks for success and investors are paid by the government if those benchmarks are reached. Usually, investors can receive a higher return if the program's performance exceeds the minimum target levels, up to a maximum payment cap.[12]

All SIBs have at least one intermediary organization that develops the SIB, raises capital, oversees the service providers and performs general project management. In addition to the intermediary organization, the government may contract with an independent evaluator to assess whether the program has reached its targets. Also, the intermediary may contract with an advisor who determines the evaluation approach, defines performance targets, monitors progress, and suggests alternative courses as needed, although more sophisticated organizations may be able to do this in addition to its project management duties.[13] Social

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10 Kristina Costa et al., *Frequently Asked Questions: Social Impact Bonds*, CTR. FOR AM. PROGRESS, 3 http://www.americanprogress.org/wp-content/uploads/2012/12/FAQSocialImpactBonds-1.pdf (last visited Apr. 20, 2014).

11 For example, social enterprises like the benefit corporation use for-profit models to affect positive social change. *What are B Corps?*, B CORPORATION, http://www.bcorporation.net/what-are-b-corps (last visited Apr. 20, 2014).

12 Liebman & Sellman, *supra* note 8, at 8.

13 Laura Callanan & Jonathan Law, *Will social impact bonds work in the United States*, MCKINSEY ON SOCIETY, 5 (Mar. 2012).

Finance, an intermediary organization involved in the first SIB implemented in the United Kingdom, successfully managed all three roles.[14] Because SIBs are new, they are still in the experimental phase and may be structured in different ways, including setting up a quasi-governmental entity to raise capital, select and organize service providers, and manage performance objectives.

B. Initiatives in the U.S.

The first Social Impact Bond was implemented in the United Kingdom in 2010 to reduce recidivism among young men released from Peterborough Prison. The financing funds organizations that provide support for 3,000 prisoners over six years, both while in prison and after they are released.[15] The program is designed to pay investors if recidivism rates drop by 7.5 percent or more. So far, the program has been extremely successful. Despite an eleven percent increase in recidivism rates nationally, the reconviction rate at Peterborough prison has dropped by twelve percent since the program's initiation, although the ultimate success of the program will not be known until the end of the six year period.[16] Since then, the United Kingdom has launched a number of additional SIB projects tackling issues of children's services, homelessness, foster care, and unemployment.

In the United States, three SIBs have been implemented to date. In February of 2012 New York City implemented a SIB to finance efforts to reduce recidivism. Funded by Goldman Sachs, the $9.6 million in up-front capital is being used to support The Osborne Association's efforts at prisoner rehabilitation.[17] If recidivism rates drop by 10 percent, Goldman Sachs will have its initial investment returned. If recidivism rates drop further, it stands to make up to $2.1 million in returns.[18] Despite the $9.6 million price tag, Goldman Sachs is not accepting the entire risk. Bloomberg Philanthropies has guaranteed $7.2 million of the start-up capital, making the arrangement part loan and part

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14 Hanna Azemati et al. , *Social Impact Bonds: Lessons Learned So Far*, 9 CMTY. DEV. INV. REV. 1, 25 (Nov. 2012).

15 *The United Kingdom: The Social Impact Bond Pioneer*, SOCIAL FINANCE US, http://www.socialfinanceus.org/social-impact-financing/social-impact-bonds/history-sib-market (last visited Apr. 20, 2014).

16 Nicky Stubbs, *Peterborough social impact bond seeing positive results*, BLUE & GREEN TOMORROW, http://blueandgreentomorrow.com/2013/11/02/peterborough-social-impact-bond-seeing-positive-results/ (last visited Apr. 20, 2014).

17 Caroline Preston, *Getting Back More Than a Warm Feeling*, NY TIMES, http://www.nytimes.com/2012/11/09/giving/investors-profit-by-giving-through-social-impact-bonds.html?_r=0 (last visited Apr. 20, 2014).

18 *Id*.

investment.[19] From Goldman Sachs' perspective, it can lose up to $2.4 million or gain up to $2.1 million.

A few months after New York City launched its SIB, Massachusetts followed suit by allocating $50 million in funding for projects aimed at reducing juvenile recidivism and chronic homelessness.[20] The recidivism project is targeting 900 juveniles who are aging out of the juvenile justice system. The project anticipates budget savings based on reduced incarceration costs. The second program is focused on housing 400 chronically homeless people and the budget savings will come from reduced Medicaid spending.[21] Third Sector Capital was selected to act as the intermediary on both of Massachusetts' pilot programs.

In December of 2013 New York State launched a SIB financed recidivism and employment program with $13.5 million raised by Social Finance. The program focuses on reducing recidivism and increasing employment in Rochester and New York City. The State recently announced that four finalists have been selected for SIB financed initiatives. The four programs address diverse social problems: one provides nurse home-visiting services to low-income first-time pregnant women, one targets pre-diabetic patients, another improves the services of school-based health centers to increase asthma care and prevent pregnancy, and the other provides diversion alternatives for juvenile offenders.[22]

With funding from the Rockefeller Foundation, Harvard's Kennedy School of Business created the Social Impact Bond Technical Assistance Lab (SIB Lab). The SIB Lab conducts research on SIBs, publishes guidance for governments on how to implement SIBs, and provides pro bono technical assistance in the form of a staff member who works with state and local governments to implement the bonds. In addition to helping Massachusetts, New York City, and New York State implement recent SIBs, the SIB Lab has awarded pro bono assistance for upcoming SIB initiatives to Chicago, Colorado, Denver, Connecticut, Illinois, Michigan, Ohio, and South Carolina.[23]

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19 *Id*.

20 *The United States: State and Local Activity: A Snapshot*, SOCIAL FINANCE US, http://socialfinanceus.org/social-impact-financing/social-impact-bonds/history-sib-market/united-states (last visited Apr. 20, 2014).

21 Liebman & Sellman, *supra* note 8, at 11.

22 *Governor Cuomo Announces Finalists Selected for the "Pay For Success" Initiative to Serve Vulnerable New Yorkers*, March 6, 2014, https://www.governor.ny.gov/press/03062014-pay-for-success (last visited Apr. 20, 2014).

23 *Harvard Kennedy Business School: Social Impact Bond Technical Assistance Lab*:

In addition to these states, California is pursuing a pilot program aimed at reducing the costs associated with treatment of children with asthma with future plans to scale the program through a SIB if successful and Santa Barbara County is exploring the potential of using an SIB to finance a recidivism intervention program.[24] Maryland introduced SIB legislation this year for a recidivism program.[25] New Jersey approved legislation that establishes a five-year pilot program that uses private investing to finance social programs focused on preventative healthcare services for low-income and uninsured populations.[26] In Oregon, the Governor's budget proposal included $800,000 for a pilot program addressing early childhood education using a social impact financing method.[27] In Utah, an early childhood education pilot program supported by a SIB backed by Goldman Sachs and JB Pritzker is underway in Salt Lake City and legislation on SIBs was introduced at the state level in 2013.[28] Washington D.C. is conducting a feasibility study of SIBs in its jurisdiction.[29]

The Obama Administration has championed the Pay for Success model of financing and has given special attention to SIBs (called Pay for Performance Bonds by the Administration). In 2012, the President proposed $100 million to fund pilot programs in five agencies addressing workforce development, juvenile justice, education, and care for disabled children.[30] The Department of Labor put $20 million into a Workforce Innovation Fund to be used for state and local governments interested in implementing Pay for Success workforce development programs.[31] The proposed budget for 2014 allocates close to $500 million to fund the Pay for Success Incentive Fund. The Department of the Treasury will oversee the fund that will serve state and local governments that are interested in implementing preventative performance based programming that saves the government money in the long term and across multiple agencies. The funds are also available to reduce investor liability by acting as partial guarantees for the upfront costs of new programs.[32]

Welcome, HARVARD SIB LAB, http://hks-siblab.org/ (last visited Apr. 20, 2014).

24 Social Finance, *supra* note 20.

25 *Id*.

26 *Id*.

27 *Id*.

28 *Id*.

29 *Id*.

30 Jonathan Greenblatt & Annie Donovan, *The Promise of Pay for Success*, 9 CMTY. DEV. INV. REV. 1, 20 (Apr. 2013).

31 *Id*.

32 *Id*.

C. International Activity

Called Social Benefit Bonds (SBBs) in Australia, the Government of New South Wales announced last year that it is developing two pilot programs with social service organizations that work to keep families together and keep children out of foster care.[33] The first SBB is funded at $7 million and will expand the service provider's program so that it can work with more families and children over the seven years of the program. The program is focused on new parent support; the goals of the program include placing children back in their homes and preventing entry into the foster program. The second SBB is funded at $10 million and funds an intensive nine month program with 400 at-risk families focusing on issues like stable housing, domestic violence, substance abuse, and debt problems.[34] The Government is currently working on a proposal for a third pilot program that would address juvenile reoffending.[35]

In addition to the bonds implemented in the United Kingdom, the United States, and Australia a number of countries are currently designing SIBs. The Government of Medellin, Columbia is designing a SIB to reduce teen pregnancy. In India and Pakistan work is underway to design SIBs addressing early childhood education and other educational issues. In addition to the four currently implemented SIBs in the United Kingdom, there are an additional twelve that are being designed. Eight of these will address workforce development and the remaining address foster care, aging in place, and adoption. Israel is developing two SIBs to address workforce development and one to address recidivism. In Africa, the governments of Mozambique, Swaziland, and Uganda are designing SIBs to prevent HIV, tuberculosis, sleeping sickness, and malaria.[36]

III. Factors Determining Success

Although there are a wide range of social problems that could be mitigated by preventative action, programs must meet very specific criteria in order to be an appropriate fit for SIB financing. According to the SIB Lab at Harvard's Kennedy

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33 Social Benefit Bonds Trial in NSW, NSW GOV. THE TREASURY, http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds/social_benefit_bonds_trial_in_nsw_FAQs#faq10 (last visited Apr. 20, 2014).

34 *Id*.

35 *Id*.

36 *Social Impact Bonds and Development Impact Bonds Worldwide*, INSTIGLIO, http://www.instiglio.org/sibs-worldwide/ (last visited Apr. 20, 2014).

School of Business, the most important factor for determining whether to implement a SIB is the potential for large scale impact.[37] Based on the SIB Lab's employees' experiences with SIBs over the last few years, the organization has realized that to be worth the immense effort that government officials and other stakeholders put into creating the programs, SIBs should at least have the potential to be implemented on a large scale.

> "To be worth the effort, SIBs require either a large initial scale or a realistic vision for scaling up an initial successful SIB into a larger (e.g., statewide) initiative. Or they need to be aligned with a broader performance or reform agenda in such a way that a successful SIB has spillover benefits into an important area of existing spending."[38]

The SIB Lab recommends pursuing projects that address issues that are high priorities of government officials and are likely to remain high priorities for years to come.[39]

Not only do SIBs need a fairly large sample size to accurately determine success but the larger the project the greater the potential cost savings. Relatively fixed costs like legal fees, due diligence, intermediary fees, and evaluation expenses will comprise a smaller portion of the overall cost with larger projects. Also, many projects may necessarily require a large scale for the government to realize maximum cost savings. For example, projects addressing recidivism reduce the government's bill incrementally for each empty bed in a prison, but the real cost savings may come from such a large reduction in reoffending that the state is able close a facility completely. An early childhood education program with a target population of only a couple classrooms of children may not create noticeable cost savings, but a program implemented throughout an entire school district may create sufficient reductions in special needs intervention that the savings is measurable in subsequent years.

Perhaps even more important than the potential to scale the project is that the project save the government money and generate returns for investors. To do this, the evaluators must be able to point to a specific effect of program success that will reduce governmental costs. For example, a reduction in Medicaid payments for homeless residents, a reduction in state costs to operate prisons or reduced state spending on special education. In each case, the success of the

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37 Azemati, *supra* note 14, at 25.
38 Azemati, *supra* note 14, at 25.
39 *Id*.

program must correlate with government savings, even if those savings will not be realized until after the end of the program.

Although all projects will inevitably create some disbursement of social and economic effects, the outcomes of the implemented projects need to have measurable, verifiable, and observable results and the impact assessments need to be credible.[40] The Center for American Progress defines "outcome" as a "narrowly defined and empirically observable result of the social intervention."[41] Unlike typical measurement of social services that measures the number of people served or the amount of aid provided, measuring the performance of SIB programs is measured by the success or failure of achieving the desired outcome. The SIB will have overarching targets, for example reducing recidivism by 8% in the target population, but the program also must have strict benchmarks to determine progressive success. McKinsey & Company recommends using an independent assessor, chosen by the intermediary and the government as a neutral party and paid on a fee-for-service basis from SIB funds, to determine if the performance targets are met.[42] Because each SIB program is different, independent assessors need to be knowledgeable about the metrics being used and how they are applied.

The most successful projects are in areas with known social interventions and proven effectiveness. Addressing recidivism and homelessness, for example, have been studied extensively and there is evidence of successful preventative programs. New untested approaches to addressing social problems are generally funded by foundations or other philanthropic sources. When those approaches have been proven to be effective, they may be suitable for consideration as a SIB project so that they can implemented at a larger scale. SIBs also are not a good option for services that the government already successfully implements. Harvard's SIB Lab attempts to identify projects that are in the "sweet spot", meaning that the projects are "sufficiently innovative that they are hard to fund through the conventional budgeting process, but likely enough to succeed that investors are willing to back [them]."[43]

Currently, a broad array of program areas could be potential fits for SIB financing. Recidivism and homelessness are the two most prominent areas, but at-risk youth aging out of foster care systems, the long-term unemployed, and at-risk preschool aged children are target populations that are being addressed as well.

40 *Id*.
41 Costa, *supra* note 10, at 24.
42 Callanan, *supra* note 13, at 5.
43 Azemati, *supra* note 14, at 30.

Preventative healthcare interventions are a ripe area for SIB financing, including prenatal and post-natal care for low-income first time mothers, early interventions for diabetes, housing modifications for asthma sufferers, and home-based care for the elderly are also potential policy areas.[44] There is potential to use a SIB type financing mechanism to fund preventative disaster relief for states and local governments that cannot afford the upfront structural improvements that would reduce federal disaster relief costs.[45] Energy efficiency upgrades or additional alternative energy production could be a target for SIB financing. As mentioned above, the potential to use the SIB model in developing countries and reduce foreign aid is being explored as well.

IV. Challenges and Criticisms

Despite the relative newness of SIBs in the United States, they have already attracted criticism. Even those promoting SIBs have identified challenges and barriers that must be addressed.[46] Some critics have commented that the economic savings are overinflated.[47] There are challenges with current appropriations frameworks at the state and local levels. Investors have voiced concern that future administrations may not honor SIB commitments or may improperly budget for the payments.[48] Nonprofits and other social service providers are concerned that annual appropriations necessarily mean that funds going to SIB financed programs will displace other social service funds.[49] There are concerns that tying financial incentives to social goals creates a situation that is ripe for corruption and concerns that governments are essentially paying for programs that already work, but using a more complex and more expensive model to finance them.[50] Some commentators have expressed an underlying uneasiness

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44 Preston, *supra* note 17 (noting that nonprofits and foundations are investigating other uses for the bonds).

45 Daniel J. Weiss & Jackie Weidman, *Disastrous Spending: Federal Disaster-Relief Expenditures Rise amid More Extreme Weather*, CTR. FOR AM. PROGRESS (Apr. 29, 2013), http://www.americanprogress.org/issues/green/report/2013/04/29/61633/disastrous-spending-federal-disaster-relief-expenditures-rise-amid-more-extreme-weather/.

46 *E.g.,* Azemati, *supra* note 14, at 22 (identifying several challenges and incorrect assumptions that the SIB Lab team has learned since implementing the first SIBs in the United States).

47 Kyle McKay, *Debunking the Myths Behind Social Impact Bond Speculation*, STAN. SOC. INNOVATION REV., 2 (Apr. 8, 2013); Jon Pratt, *Flaws in the Social Impact Bond/Pay for Success Craze*, NONPROFIT QUARTERLY (Apr. 17, 2013).

48 Costa, *supra* note 10, at 18.

49 Pratt, *supra* note 26.

50 *Id*.

about for-profit financial innovation playing a role in solving social problems.[51] At least one commentator has suggested that participating tax-exempt nonprofit service providers could be at risk of losing their tax-exempt status.[52] All of these challenges and concerns address the underlying issue of risk allocation. The innovation of the SIB is the shift of financing risk from the government to private investors, but with the new model comes a range of additional risks that are not so easily pushed off.

A. Cost Savings

In Maryland, the Department of Legislative Services was tasked with determining the feasibility and potential benefits of a SIB financed reentry program.[53] The group found that a pilot program, like the one contemplated, would likely not save enough to finance the costs of the program completely and may increase budgetary pressure.[54] The author of the Maryland feasibility study, in an article published in Stanford's Social Innovation Review, cites attorneys', consultants, and program evaluator costs, as well as the necessity of most governments to appropriate funds for successful programs, as reasons for the increased pressure on government budgets.[55] He points out that most reentry pilot programs, because of the small size, are not able to create substantial savings to governments.[56] Proponents of SIBs have acknowledged the difficulty in finding programs that generate enough cost savings to offset program costs.[57] This is partially because initial pilots have been small and the techniques experimental.[58]

By contrast, the recidivism programs implemented in Massachusetts and New York seem well-positioned to realize the states' significant cost savings.[59] In Massachusetts the recidivism rate for at-risk youth is nearly 40% and the State

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51 *E.g.,* Andrew Palmer, *Playing with Fire*, THE ECONOMIST (Feb. 25, 2012).

52 Peter G. Dagher Jr., Note, *Social Impact Bonds and the Private Benefit Doctrine: Will Participation Jeopardize a Nonprofit's Tax-Exempt Status?*, 81 FORDHAM L. REV. 3479, 3479 (May 2013).

53 Kyle A. McKay, *Evaluating Social Impact Bonds as a New Reentry Financing Mechanism: A Case Study on Reentry Programming in Maryland*, MD. DEP'T OF LEGISLATIVE SERVS., v (January 2013) [hereinafter *Maryland Case Study*].

54 *Id.*

55 McKay, *supra* note 46, at 2.

56 *Id.*

57 Azemati, *supra* note 14, at 26.

58 *Id.*

59 Leonard Gilroy, *The Emergence of Social Impact Bonds: Paying for Success in Social Service Innovation*, REASON FOUND. (Apr. 22, 2013), http://reason.org/news/show/apr-2013-social-impact-bonds#citeC3.

spends approximately $45,000 per year on each inmate.[60] Roca, Youth Options Unlimited, the service provider that has been selected to provide the preventative programming, has less than a 2% re-incarceration rate for participants. Roca spends approximately $5,000 per participant per year.[61] In this scenario, Massachusetts stands to save a substantial sum of money if the program is successfully scaled. In New York, even at the baseline 10% reduction in recidivism the City stands to net $1 million in long-term savings and at the high-end of 20% reduction the City would realize $20 million in long-term savings.

In the Maryland study, the Department of Legislative Services created projections based on an assumed 250 program participants each year and concluded that the costs of the program outweighed any potential savings the State could realize.[62] By contrast, the New York Program at Riker's Island serves roughly 3,000 inmates each year and the Massachusetts recidivism project targets several thousand youth aging out of the corrections system and probation system each year. Unfortunately, it may be true that the cost savings for many states interested in small pilot programs does not cover the program costs. The true benefit of SIB financing is the ability to scale successful pilots and that requires large target populations to realize cost savings in many instances. Massachusetts was recently awarded an additional $11.67 million in the form of a grant from the U.S. Department of Labor to expand its recidivism programming.[63] The availability of supplemental federal funding may make it possible that other SIBs be implemented on a larger scale and thus increase the potential for cost savings.

B. Budgeting and Appropriations

Another critic points out that SIBs will necessarily displace funding for other programs because legislators are unlikely to "appropriate additional funds based on a projection of future savings."[64] The issue of appropriations is a legitimate concern and roadblock for many governments that are considering

60 *Id.*
61 *Id.*
62 *Maryland Case Study*, *supra* note 52.
63 Press Release, Third Sector Capital Partners, Massachusetts Awarded $11.67 Million U.S. Department of Labor Grant for Pay for Success Project Led by Third Sector Capital Partners (Sept. 23, 2013), http://www.thirdsectorcap.org/wp-content/uploads/2013/09/130923_DOL-Award-Press-Release.pdf.
64 Pratt, *supra* note 46.

implementing SIBs. Most appropriations statutes prohibit governments from committing to multiyear or contingent contracts. Jeff Liebman, at Harvard's SIB Lab, has recommended that governments pass an appropriations statute that "authorizes long-term contracts and allows for future redirection of any unused funds, for another closely related high-priority purpose."[65]

There are also concerns about appropriations processes, particularly from investors who must rely on legislatures to pay for commitments years after program implementation.[66] In Massachusetts, legislation was passed that set up a sinking fund and gave the Secretary of Administration and Finance the authority to request annual appropriations equal to the cost the State expects to pay for a successful program. .[67] Language was included in the legislation that backs the pay for success contracts with the "full faith and credit" of the State.[68] This language and the sinking fund reduce the risk that a future administration will try to avoid payment at the end of the bond, however, the payments required to go into the sinking fund are certainly displacing funding from other areas. Arguably, however, governments may be recovering a percentage of the program costs if they are able to invest and earn a return on the money set aside for future payments and, of course, the money that is put into a sinking fund may become available for other programming if the SIB is unsuccessful.

The other approach that has been taken to eliminate investor concern over future payments and to reduce the amount of total risk taken on by investors is to involve a foundation that guarantees the investment up to a certain dollar amount. In New York City, Bloomberg Philanthropies guaranteed $7.2 million of the $9.6 million investment made by Goldman Sachs. In Utah, J.B. Pritzker foundation has committed $2.4 million and Goldman Sachs has committed $4.6 million toward an early childhood education initiative. The Pritzker foundation's investment is subordinated to Goldman Sachs' which reduced the Goldman's risk.[69]

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65 Jeffrey B. Liebman, *Social Impact Bonds: A Promising New Financial Model to Accelerate Social Innovation and Improve Government Performance*, CTR. FOR AM. PROGRESS, 1 (Feb. 2011), http://www.americanprogress.org/issues/2011/02/pdf/social_impact_bonds.pdf.

66 *Id.*

67 An Act Making Appropriations for the Fiscal Year 2012 to Provide for Supplementing Certain Existing Appropriations and for Certain Other Activities and Projects, Legislation No. 3898 § 35XX (proposed Jan. 25 2012), http://www.mass.gov/legis/journal/desktop/Current%20Agenda%202011/H2898.pdf.

68 Liebman & Sellman, *supra* note 8, at 25.

69 Fact Sheet: The Utah High Quality Preschool Program, GOLDMAN SACHS, http://www.goldmansachs.com/what-we-do/investing-and-lending/urban-investments/case-studies/impact-bond-slc-multimedia/fact-sheet-pdf.pdf (last visited Apr. 20, 2014); William Alden, *Goldman Sachs to Finance Early Education Program*, NY

The drawback to creating a sinking fund to set aside annual contingent payments is that it reduces the amount of money available for current year social services. The benefit, however, is that appropriating the payments each year does not alter the risk allocation inherent in the SIB model. The government will have access to those funds and can redirect them elsewhere if the program is unsuccessful. Including a philanthropic organization as an investment guarantor or as an investor with a subordinated claim can mitigate the risk assumed by investors and alleviate the unease about administration changes affecting future payment, however the number of philanthropic organizations with the ability to guarantee a large percentage of investor financing is small. The federal government will hopefully grow in this space to assist foundations in taking on a partial assumption of the risk.

In some cases, the cost savings realized by the government may correlate with the payments made toward the end of the program. For example, in Utah the State pays $2,600 per student per year for special education for students in the general education classrooms.[70] For each year that program participants do not require special education remedial services from kindergarten through sixth grade the State will instead pay investors the per student rate to cover the initial investments plus a 5% return.[71] After the initial investment has been repaid, the State pays investors 40% of the avoided cost for students through sixth grade.[72] In addition, the State only pays investors for avoided special education services through sixth grade, any avoided costs per student after sixth grade are recouped by the State and school district.[73]

C. Corruption

Given that governments and investors are likely to want to invest in programs with evidence-based success records some critics cite concerns of "cream-skimming", where projects with proven track records of success will be selected for SIB financing, with the government ultimately paying a risk premium

TIMES (June 12, 2013), http://dealbook.nytimes.com/2013/06/12/goldman-to-invest-in-utah-preschool-program/?_r=0.

70 *Id.*

71 *Id.*

72 *Id.*

73 *Id.*

for programs that already work.[74] The Center for American Progress notes that concerns about "skimming" are well-founded and reiterates the need for a well-defined treatment population.[75] The Center also points out that remedial programs for hard-to-serve populations are often the most expensive, which creates a greater incentive for targeting those populations with preventative programs, and reduces the likelihood of "skimming".[76]

Some nonprofit leaders are concerned about the potential for corruption when tying social benefit to financial return. Mark Rosenman, director of Caring to Change and emeritus professor at Union Institute & University, expressed his concerns in a New York Times article last year, "When we seek to introduce the profit motive, we begin to abandon who we are as a people and abandon our responsibility for the common good in pursuit of private profit."[77] Jon Pratt, Executive Director of Minnesota Council of Nonprofits, agrees and cited Campbell's Law, "The more any quantitative social indicator is used for social decision-making, the more subject it will be to corruption pressures and the more apt it will be to distort and corrupt the social processes it is intended to monitor."[78] A recent Washington Post article about Goldman Sachs' new impact fund begins "[w]hen faced with an investment bank saying that it's going to do something for "social impact," it's fair to interrogate its motives."[79]

But does it really matter? Goldman Sachs and other large banks have many reasons to be involved in social investments. Perhaps the most important reason for big banks to be involved in impact investing activities is because they desperately need to improve their reputations in the wake of the financial recession.[80] Aside from public relations-related motivations, client demand for impact investments has increased significantly in the last few years and banks are obliged to respond to the increased demand. The very nature of SIBs, which focus

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74 McKay, *supra* note 46; Mark Rosenman, *At Rikers Island, Investing in Decision-Making Lessons for Teens in Trouble,* PBS NEWSHOUR (Apr. 10, 2013), http://www.pbs.org/newshour/bb/business/jan-june13/prison_04-10.html.

75 Liebman, *supra* note 64, at 4.

76 *Id. at 26*

77 Preston, *supra* note 17.

78 Pratt, *supra* note 46.

79 Lydia DePillis, *Goldman Sachs thinks it can make money by being a do-gooder*, THE WASHINGTON POST (Nov. 5, 2013), http://www.washingtonpost.com/blogs/wonkblog/wp/2013/11/05/goldman-sachs-thinks-it-can-make-money-by-being-a-do-gooder/.

80 Melissa Ip, *Joining the Party: Goldman's $250M 'Social Impact Fund'*, SOCIAL ENTERPRISE BUZZ (Nov. 4, 2013), http://www.socialenterprisebuzz.com/2013/11/04/joining-the-party-goldmans-250m-social-impact-fund/.

on social behavioral changes rather than asset values, means that they are uncorrelated to traditional market factors and offer investors a unique way to diversify a portfolio.[81] There are also efforts to align SIB initiatives so that they fit Community Reinvestment Act standards.[82] The Community Reinvestment Act of 1978 (CRA) encourages banks to invest in the communities in which they operate, including low-income populations, and banks are evaluated annually.[83] Structuring SIB investments to count toward CRA requirements is an added bonus to banks.

Finally, because the underlying motivation of SIBs is to save the government money by eliminating or reducing the need for remedial services, banks can make money by investing in them. Goldman Sachs' CEO Lloyd Blankfein put it this way "[a]t a time when government doesn't have the wherewithal to come up with that one dollar, and as consequence will have to come up with four dollars, I'll come up with the one dollar, and we'll split the extra three dollars."[84] The SIB model does not assume that investors are interested solely in social benefit, the financing mechanism is set up to generate a return for investors, but the balance of interests between investors, the government, the service provider, and the intermediary do not give investors any advantage or opening to influence the outcome of performance evaluations.

D. Financial Innovation

Other critics take issue with the underlying assumption that these pay for success arrangements will somehow incentivize service providers to deliver services more efficiently and therefore create more innovative service methods, when there is no evidence that this is the case.[85] These criticisms seem to be in response to more exuberant claims about SIBs than those advising on and implementing them are making. The Center for American Progress emphasizes the usefulness of SIBs to finance preventative evidence-based programs that save

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81 McKinsey & Company, *Social Impact Bonds Webinar Panel*, YOUTUBE (May 23, 2012) (Tracy Palandjian from Social Finance Inc., discussing potential diversification benefits of SIBs), http://youtu.be/wdU2tLqT5HA [hereinafter *SIB Webinar*]
Jill Scherer & Lynn Schenk, *Advancing Social Impact Measurement to Build an Asset Class: The Appeal of Social Impact Bonds*, 24 CMTY INV. 1, 5 (2012), http://www.socialfinanceus.org/sites/socialfinanceus.org/files/SF.FederalReserve.Spring2012.pdf.

83 *Community Reinvestment Act*, FED. RESERVE, http://www.federalreserve.gov/communitydev/cra_about.htm (last visited Dec. 13, 2013).

84 DePillis, *supra* note 78.

85 Pratt, *supra* note 46.

the government the costs of more expensive remedial services down the road.[86] These types of preventative programming, they contend, often do not have the necessary funding to enlarge and sustain the program, and governments are more likely to cut funding to preventative programs than remedial ones when budgets are tight.[87] SIBs, therefore, serve as a catalyst to scaling effective preventative social services, not an incentive to improve service providers' efficiency. The innovation is really in the financial mechanism, not the programming.

After the devastating effects of the recession, the term "financial innovation" may bring to mind thoughts of other less beneficial financial innovations, like credit-default swaps and collateralized-debt obligations (CDOs, or more accurately CDOs squared), which were likely instrumental in bringing about the near collapse of many of the country's largest banks. In some ways the SIB does mimic other financially innovative instruments. The SIB is focused on aligning all the participants' goals, a large part of the innovation of the SIB is the transfer of risk, and standardization and performance measurements are inherent in the model.[88]

Even these similarities with other potentially flawed financial instruments do not indicate that the SIB will ultimately be harmful to society. First, transparency between participating parties is essential to a properly functioning SIB. The lack of transparency in both credit-default swaps and collateralized debt obligations is very likely a key reason that they had such a harmful effect on the financial system.[89] Second, SIBs are small multi-party contracts within an extremely small sphere of the financial industry. They do not, and likely will not, have the potential to create the type of catastrophic ripple effects that occurred during the financial crisis. Although the model has generated widespread interest by governments, the universe of potential social ills that can be successfully addressed by SIB financing is limited and each SIB implemented requires extensive case-specific due diligence. Finally, whereas standardization in finance is often the catalyst for developing new financial markets, the ability to standardize SIBs is also limited to specific program focuses and further limited by individual state and local regulations.[90] Each SIB contract is negotiated taking into account the particular circumstances and interests of the parties.

86 Costa, *supra* note 6, at 6.
87 *Id.*
88 Palmer, *supra* note 50.
89 Frank Partnoy & David A. Skeel Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019, 1050–51 (2007).
90 *Id.*

E. Contracting

The complex contracting required to implement a SIB carries inherent risks and may be unfamiliar territory for many governments.[91] Although each party ultimately wants the program to be successful, how success is defined is likely to be a point of contention because those target successes trigger payment. The government naturally wants a high bar for success, while investors want a low bar. How evaluators and assessors are chosen, which performance metrics to use, caps on investor returns, firm investor commitments even during periods with little or no success, and the potential for program changes are all issues that need to be addressed and negotiated to suit the needs of the parties. Ultimately, the contracts need to reflect each party's expectations. Risk allocation and any contingencies need to be clearly detailed, termination provisions will be particularly important, and relationships and expectations of performance need to be clearly explained in the master agreement.

The master agreement, or the main agreement, is between the government and the intermediary. In most versions of the SIB, the intermediary is like the hub and the government, service providers, investors, and others are the spokes. The intermediary will be party to a contract with the government, the investors, the service provider, as well as an independent evaluator and assessor. There will also be additional contracts, for example, between the government and investors and the government and the independent assessor. The Center for American Progress (CAP) has put together an annotated model SIB agreement that addresses general issues that need to be contemplated and included.[92] Central to the agreement are the defined roles and responsibilities of the two parties. The CAP recommends that the agreement include contact personnel for both the intermediary and the government agency with clear descriptions of each party's role.[93]

Issues of control are extremely important and need to be addressed. For example, the intermediary necessarily needs freedom to make decisions about the implementation of the program but the government may want some control over the decision of which service providers to subcontract with. The intermediary needs the freedom to make quick and fluid decisions to change the program delivery if the current delivery is proving unsuccessful. Despite this, the government will likely want some parameters as to when it can intervene. The CAP recommends including language that would give the government the right to

91 Mckay, *supra* note 46; Kohli et al., *Inside a Social Impact Bond Agreement*, CTR. AM. PROGRESS, 1 (May 3, 2012).
92 *Id.*
93 *Id.* at 9.

object or intervene in three scenarios: "(a) if the program group or other persons are at risk of harm; (b) where the external organization's actions could increase costs to government or others; or (c) where there is significant reputational damage to government."[94]

From a legal perspective, these provisions are fairly ambiguous. It would behoove both parties to more clearly define what are and are not acceptable additional costs to the government, what types of risk or harm are contemplated and how that harm is measured, and how to determine "reputational damage". For example, does the damage have to have already occurred or can it just be a risk of reputational damage? The CAP also recommends including provisions defining the position of arbiter and assigning any disputes to the mutually-agreed-upon arbiter.[95]

The other issue that needs considerable attention in this type of contract is defining the target population and the control group. The CAP recommends agreeing on these definitions and program details before signing the agreement.[96] The specifics can be attached as an appendix. If the group is fluid, meaning that new people may qualify for services throughout the life of the SIB, those additional groups need to be separated into cohorts so that they can be accurately compared with the control group.[97] The CAP recommends using randomization to allocate people to the program groups, when feasible.[98]

The other issue is defining and agreeing on a methodology for success and a payment schedule. Outcomes should be measured as accurately as possible, which means that it is important from the government's perspective that the methodology exclude positive outcomes that result from chance, and from the intermediary's perspective the contract should protect it against factors beyond its control.[99] The CAP recommends using outcome data that is already developed and being used in other areas, when possible.[100] Similarly, the contract should include a payment schedule and provisions that guard against incentivizing bad behavior. For example, for a SIB financing a program that is aimed at reducing long-term unemployment, the payment schedule and outcome methodology should ideally not apply to situations where the organization itself is hiring people

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94 *Id.* at 10.
95 *Id.* at 14.
96 *Id.* at 4.
97 *Id.* at 4.
98 *Id.*
99 *Id.* at 6.
100 *Id.*

from the target population to boost its performance numbers.[101]

Any contracting pitfalls will soon be realized as more SIBs are implemented. Lawyers are trained to handle complex financing and performance obligations with multiple parties, and pay for performance contracts are certainly nothing new. The Maryland case study cited the untested model and the ability of investors to walk away from the SIB if it is not meeting its performance metrics as reasons that the government would likely bear more of the financial risk than is superficially assumed.[102] Just because SIB arrangements are unfamiliar to governments and other parties does not necessarily increase the chance of incorrectly allocating risk, and the ability to terminate the agreement should be a central negotiation point and be included in any contract. The beauty of contractual arrangements like the SIB is that parties can negotiate for risk and control, including termination rights.

F. Capability and Capacity

Perhaps the most dynamic player to emerge from the SIB financing model is that of the intermediary. This new organization has to have an incredibly varied and broad knowledge base and superior project management and communication skills. In most iterations of the SIB the intermediary is tasked with engaging investors and raising capital, overseeing nonprofit service providers and analyzing performance metrics, identifying breakdowns in service and implementing corrective action, communicating with the government and investors throughout the project, and managing the expectations of all the parties. In a society where professional expertise is usually limited to one sphere, the intermediary has to span all three traditional sectors— public, private, and social.[103]

Social Finance U.S. was the first organization in the United States to act as an intermediary in a SIB financed program. Social Finance U.K. launched the first SIB in England and Social Finance U.S. was launched not long after to serve the same role in the United States.[104] Community Development Finance Institutions and Community Development Venture Funds are potential organizations that are well positioned to become intermediaries for SIB financing arrangements.[105] SIB

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101 *Id.*

102 *Maryland Case Study*, *supra* note 52, at 12.

103 *E.g., supra* note 5 (discussing the emergence of organizations that span the traditional three sectors).

What we do, SOCIAL FINANCE US, http://socialfinanceus.org/what-we-do/history-social-finance-inc (last visited Apr. 20, 2014).

105 *SIB Webinar*, *supra* note 80.

programs represent a distinct shift away from traditional types of community investing which has focused primarily on low-income housing and other real property assets.[106] Although the underlying asset in a SIB program is the social behavioral change that triggers governmental cost savings, the needed skills to manage a SIB arrangement are similar to the skills needed to manage, for example, a New Market Tax Credit arrangement or a business enterprise investment in a distressed area. Other organizations that may be well positioned to act as intermediaries are impact investing advisors and consulting firms.[107]

With any new industry come risks. Because the role of intermediary is a novel creation, most intermediary organizations are likely to be in their infancy which carries the risk that the organization will not survive the life of the SIB. Intermediary organizations with a background heavily weighted in finance or social service, for example, may be unable to balance the varying needs of all of the parties. The complexity of the SIB model requires an organization that has a deep knowledge of each of the sectors as well as the ability to balance those interests long-term.

Just as the intermediary has to have the capacity, capability, and stamina to be successful in a SIB arrangement, the government and the service provider must have the capability and capacity to fulfill their roles over the life of the bond. The government needs a dedicated team with technical expertise, willing to put many hours into getting the SIB up and running on the front end and continued focus through changes in administrations and other political shifts to see the SIB through.[108] Harvard's SIB Lab, which puts a full-time government innovation fellow at select state or local government agencies that are entering into SIB initiatives, recommends choosing programs that focus on top agency and regional priorities that are unlikely to change with a change in administration.[109]

Likewise, the service providers selected for a SIB must have the capabilities and capacity to scale the program. Many service providers operate in small geographic areas and it may be a challenge to scale the operations and transplant the program successfully to another area.[110] Service providers need a good management team, a solid understanding of the assessment mechanism and how to implement it.[111] They need to have connections with the community and

[106] *Id.*
[107] *E.g.* Third Sector Capital Partners, http://www.thirdsectorcap.org.
[108] Azemati, *supra* note 14, at 28.
[109] Liebman & Sellman, *supra* note 8, 14–15.
[110] Azemati, *supra* note 14, at 28.
[111] *SIB Webinar*, *supra* note 80.

target population and be open to multiparty feedback throughout the program.[112] Harvard's SIB Lab has recognized the challenge of finding providers with appropriate capacity and the additional "execution risk" that may come from attempting to scale programs statewide or transplanting programs to other states.[113]

V. The Future of Social Impact Bonds

Ultimately, the success of SIBs as a practical approach to scaling preventative social service delivery programs will depend on managing and mitigating, as much as possible, the multitude of risks that arise from the multidimensional contracting arrangement. If philanthropy is the risk capital for the social sector, then government is the traditional "scale up" capital for successful programs.[114] Governments are naturally risk averse, however, which is why they are hesitant to invest in preventative programs, even when the programs have some track record of success. This breakdown in the system results in successful pilot programs unable to take the next step.[115] Private investors may be more willing to accept the financial risk than governments, but to shoulder the full risk of failure private investors will need more evidence of successful programs. Currently, SIB initiatives are experimental and the success or failure of current programs is unknown. The first wave of SIBs will likely be funded the way the first few have been, with financial institutions and philanthropic organizations sharing the risk. Two trends, however, create a promising environment for SIBs. First, investors are increasingly demanding social impact in addition to financial returns and second, philanthropists and donors are increasingly focused on accountability and performance metrics.[116]

The hope is that a proven track record of success will encourage more private investors to invest in SIBs, but it may also be necessary for governments to assume some of the risk. Although there are a limited number of projects that will cover government costs completely, governments may still be interested in pursuing projects that cover most of the costs while also producing social benefits.[117] Common sense dictates that social benefits like reduced crime or

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112 *Id.*

113 Azemati, *supra* note 14, at 28.

114 *SIB Webinar*, *supra* note 80.

115 Callanan, *supra* note 13, at 3.

116 John Vogel & Georgi M Klissurski, *Everything You Need to Know About Social Impact Bonds,* US NEWS & WORLD REPORT (Nov. 5, 2013), http://www.usnews.com/opinion/blogs/economic-intelligence/2013/11/05/everything-you-need-to-know-about-social-impact-bonds.

117 Azemati, *supra* note 14, at 30.

improved health have a positive effect on both society and the economy, even if those benefits are not easily measured. It may be possible to measure a reduction in emergency room visits by homeless people in a given period, for example, and attribute the cost savings to the homelessness reduction program, but it may not be as easy to measure the cost savings across many agencies or over many years.

A formerly homeless person who finds stable housing, affordable medical care, and employment will generate economic benefits for the government that are difficult to trace, for example, in the form of taxes paid, reductions in the costs of police intervention, and a long term reduction in costs in healthcare. Other cost savings may be even more difficult to measure, for example a large reduction in homelessness may increase housing prices in a particular area or increase business to retailers, all of which has a general positive effect on the local economy in addition the benefits to society. As SIB initiatives prove successful in producing the social behavior change that they are targeting, governments may decide to take on some of the risk of failure in order to grow a program that has the potential to create long-term social and economic benefits.

The Federal Government could prove instrumental in incentivizing impact investment. The Obama Administration has taken the first steps toward urging the impact investing sector along by establishing the Pay for Success Initiative Fund and providing grants to help partially fund SIB initiatives.[118] The Federal Government should continue to explore pay for success opportunities across agencies, including for disaster relief prevention, education, and workforce development. To eliminate any concerns over loss of tax-exempt status for nonprofits participating in SIBs, the IRS should issue a revenue ruling explicitly declining to apply the private benefit doctrine to SIB arrangements.[119] Congress could incentivize investments in SIBs by creating a tax benefit for investors. The United Kingdom recently announced a plan to allow investors a 30% tax credit for investments in social impact bonds and social enterprises.[120] The tax credit is estimated to make available an additional £500 million.[121] The U.S. Federal

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118 Greenblatt, *supra* note 29, at 20.

119 Dagher Jr., *supra* note 51 (discussing the potential applicability of the doctrine to nonprofits participating in SIB arrangements).

120 Rebecca Burn-Callander, *Autumn Statement 2013: Social enterprises granted tax relief*, THE TELEGRAPH (Dec. 5, 2013), http://www.telegraph.co.uk/finance/budget/10498795/Autumn-Statement-2013-Social-enterprises-granted-tax-relief.html.

The UK Introduces Groundbreaking Social Investment Tax Relief, NONPROFIT FIN. FUND, http://payforsuccess.org/resources/uk-introduces-groundbreaking-social-investment-tax-relief (last visited Apr. 20, 2014).

Government could create a similar incentive or could exempt investments into social impact vehicles from capital gains tax.[122]

Even SIB initiatives that prove successful may not be cost effective to continue after the SIB period is over. Governments may choose to continue the program by contracting directly with the service provider, rather than using the same SIB financing model, thus saving the added costs of paying a return to investors and paying intermediary and consultant fees. The intermediary, however, may prove to be an extremely useful and effective liaison and project manager that adds value to the contractual relationship even without the involvement of private investors. Governments should consider these various options of continuing the social service program after the SIB is over even in the initial phases of implementing the SIB, and should include a good faith commitment to consider extending the program after the end of the bond. This may require creating a pro forma budget for future years and including it in the normal budgetary process to ensure that a successful program is not interrupted.

To mitigate barriers to implementing SIBs, governments should consider and pass legislation that allows for multiyear performance-based contingent contracts and should guarantee those commitments, like in Massachusetts, with the "full faith and credit" of the state. To prepare for SIB financing, governments and service providers should educate themselves on the various initiatives currently in existence. For SIB financing to be successful, all of the relevant parties need to be educated and knowledgeable about the financing mechanism as well as inherent risks of the model. Governments will need to distinguish the SIB model from other, more familiar, pay for performance contracts and public-private partnerships. The Nonprofit Finance Fund has already created seminars and training programs to help nonprofits prepare for SIB and other pay for success models.[123]

VI. Conclusion

The amount of interest and excitement generated over SIBs is somewhat startling considering that there has yet to be a successfully completed SIB initiative. Despite the lack of data from completed SIBs and the complexity in the

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122 Benjamin R. Cox, *Financing Homelessness Prevention Programs with Social Impact Bonds*, 31 REV. BANKING & FIN. L. 959, 981–82 (2012).

123 Nonprofit Finance Fund Leading "Boot Camps" to Prepare Nonprofits for Pay For Success Funding, NONPROFIT FIN. FUND (Sept. 9, 2013), http://nonprofitfinancefund.org/announcements/2013/nonprofit-finance-fund-leading-%E2%80%9Cboot-camps%E2%80%9D-prepare-nonprofits-pay-success-fundin.

arrangements, the potential for increasing the number and reach of preventative social services is promising. Although governments, investors, and service providers should be aware of the challenges and risks involved in the new arrangement those challenges and risks are not insurmountable and will likely lessen over time. Ideally, a variety of SIB initiatives will be implemented in the coming years so that an overall success rate can be established. The first wave of SIBs have the potential to help break down the walls separating the private, public, and social sectors, and be a permanent part of the emerging fourth sector. Social Impact Bonds have the potential to make people rethink the roles of nonprofits, private investors, and government and increase collaboration on all fronts.

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