Pay for Success Financing for Early Childhood Programs: A Path Forward

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INSTITUTE *for* CHILD SUCCESS

(introduction)

We can do better for our children. Far too many endure preventable health or behavior problems. They are not prepared for school and do not graduate with the tools they need for successful careers. Programs that can effectively prevent these problems reach only a fraction of the children who could benefit, and they struggle constantly for funding to continue, let alone grow.

The Institute for Child Success (ICS) has dared to imagine a different future: one in which every high-risk mother in an under-resourced state learns to read to her child every day, to use effective parenting when a child misbehaves, and to provide healthy food and exercise; a future in which high-quality medical care, childcare, and early education are the norm. Could we reach a new normal, in which we have robust early childhood programs and fewer children in special education, foster care, and prison? We believe that we can, and that Pay for Success financing can help us get there.

Pay for Success (PFS, also known as outcome-based financing) is attracting increasing attention from many quarters. In PFS, funding for programs is based at least in part on their achieving specific, predetermined outcomes. In one popular type of PFS financing (also called a Social Impact Bond, or SIB) private investors put up capital for proven interventions and government pays them back, after an impartial evaluator finds evidence that the interventions are working. It is a new and still relatively untested mechanism, particularly in the United States, so many questions remain.

ICS believes that PFS holds enormous promise for improving children's lives. We have already conducted a feasibility study of its potential to scale up early childhood programs in South Carolina, in particular the Nurse-Family Partnership, a successful program for low-income first-time mothers.[1] We learned a great deal about its potential benefits, the types of projects it is best suited for, and challenges to be aware of. We are indebted to the Connecticut Center for

1 Institute for Child Success. Using Pay for Success Financing to Improve Outcomes for South Carolina's Youth: A Feasibility Study. September 2012. Available at http://www.instituteforchildsuccess.org/

In This Brief:

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Social Innovation[2], which specializes in designing metrics and securing funding for early childhood PFS projects, for supporting our work on PFS.

In this brief we share lessons we learned from analyzing the feasibility of PFS for the Nurse-Family Partnership and address how PFS financing might apply to the broader field of early childhood interventions. We hope it will help advocacy organizations, foundations, government officials, and financiers assess how they might use PFS financing to improve outcomes for children.

(early interventions for children: benefits and obstacles)

There is growing evidence that what happens in children's first five years of life influences their health, educational success, and behavior well into the future. For instance, the Center on the Developing Child at Harvard University has documented the negative effects of toxic stress on children's developing brains, especially in the first two years of life.[3] Fortunately, the evidence also provides cause for hope: it shows that effective interventions can improve children's outcomes and even mitigate the effects of childhood trauma or toxic stress.

Early childhood interventions that have been shown to improve outcomes for children

- Home visiting programs (example: the Nurse-Family Partnership)
- Pre-kindergarten programs for three- and four-year-olds (example: Chicago Child-Parent Centers)
- Other early care and education programs (example: early Head Start)
- Early intervention programs for children with developmental delays (Example: Help Me Grow)
- Programs to strengthen families (example: Triple P)

There is still a great deal of work to be done to develop the most effective early childhood interventions. Even so, a number have been shown to improve children's lives, when implemented well. (See box.) Two of the best known are home visiting programs and high-quality pre-kindergarten programs.

The benefits of these programs to society extend beyond the well-being of its most vulnerable citizens. (See box.) Early interventions also produce economic benefits. Many of them deliver net savings for government in the long run, especially when they are provided to the young children who face the greatest risk of negative outcomes.

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The Nurse-Family Partnership, the subject of ICS's earlier feasibility study, shows how these combined social and economic benefits far exceed the program's costs. For instance, participants had fewer preterm births—an obvious benefit for the children involved, and a

2 For more information: www.connecticutcenter.org

3 Center on the Developing Child web site: http://developingchild.harvard.edu/

result that sharply reduced costs to the state, since premature babies require extensive medical care. A longer-term benefit of NFP was a lower rate of youth crime. Again, this result clearly helped children who stayed out of trouble and the people who avoided becoming their victims; government also benefited by avoiding the substantial costs of incarceration.

Social and economic benefits from early childhood interventions

- Fewer preterm births
- Fewer teen pregnancies
- Fewer closely spaced second births and fewer preterm second births
- Fewer injury-related visits to the emergency room
- Reductions in child maltreatment
- Children more ready for kindergarten
- Less youth crime
- Reduced incarceration rates
- Higher achievement in school or careers
- More economically independent mothers
- Increased earnings

Yet despite wide agreement that it would be good policy to develop and broadly implement effective early childhood programs, that isn't happening. Programs are in place, of course, but at nowhere near the scale needed to make a big impact. There are inherent challenges to scaling up early childhood programs that have been difficult to overcome.

Two stand out:

- *Resources are tied up in responding to problems, leaving little for prevention.* Governments are busy putting out fires—that is, responding to problems after they happen. Strapped for cash, they are rarely able to devote up-front resources to developing or implementing effective methods to prevent problems in the first place, even though over the long term such approaches would save them money. The Institute of Medicine has documented the costs of failing to focus on prevention, finding that many mental, emotional, and behavioral disorders in young people are preventable, but that prevention remains underfunded.[4]

- *The costs of wide-scale implementation are immediate, but the payback takes time.* Although many programs will deliver both social and financial—and thus political—returns, those benefits take time. Governments often find it difficult to justify investments with delayed returns.

4 National Research Council (US) and Institute of Medicine (US) Committee on the Prevention of Mental Disorders and Substance Abuse Among Children, Youth, and Young Adults. Preventing Mental, Emotional, and Behavioral Disorders Among Young People: Progress and Possibilities. 2009. Available at http://www.ncbi.nlm.nih.gov/books/NBK32775/

(PFS financing addresses the obstacles to wide-scale implementation of proven programs)

A new method of financing, Pay for Success, or PFS, holds promise for overcoming these obstacles. PFS funding is based at least partially on the outcomes that programs produce. PFS must be distinguished from funding that pays for services that are conducted but is silent on the results of those services.

Pay for Success financing: varied models

There are several ways that outcomes can be considered in financing:

- *Outcomes are tracked and considered in decisions on resource allocation.* Evidence might come from past research, or from programs as they're being implemented.
- *Incentives or bonuses are issued for good outcomes.* In this system, government maintains the risk, rather than transferring it to a provider or investor.
- *Funding depends in significant part on outcomes achieved.* At least some of the risk of failure to achieve outcomes is transferred to the program or its funders. Investors may front capital, and be repaid based on agreed-upon outcomes.

PFS financing comes in several forms (see box), but one type, often called the Social Impact Bond (SIB), is receiving particular attention. (Despite its name, this form of financing is not a true bond.) With SIBs, private investors or philanthropies provide the up-front capital necessary to scale effective programs. Government pays the investors back, plus a modest return, once an impartial evaluator has determined that previously agreed-upon outcomes have been achieved. Funding comes at least partially from the savings generated.

PFS financing benefits a wide range of parties: providers and their philanthropic supporters, government, investors, and society. (See box.)

Who benefits from PFS financing?

- Communities and individuals get more effective services and better results
- Service providers get up-front funding that allows them to scale up programs
- Government receives more cost-effective services and better results
- Investors receive modest returns and are able to help solve social problems

There could be a significant amount of new capital available to scale effective programs via this PFS financing. A J.P. Morgan report estimates that 400 billion to one trillion dollars in impact capital may be available for a range of socially minded investments.[5] Goldman Sachs alone has launched a social impact fund with a target of $250 million to invest.[6]

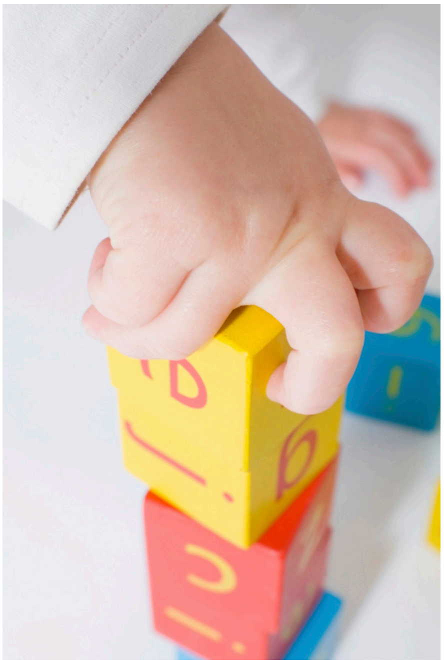
(early childhood programming: an excellent prospect for PFS)

PFS is still so new that worldwide, only seven transactions have been completed. Results from the first one, in Peterborough, UK (designed to reduce recidivism among adults leaving prison), will be released in 2014.

But interest in PFS is running very high. Many other PFS deals are in process and will be announced soon.

5 J.P. Morgan Global Research. Impact Investments An emerging asset class. November 2010. Available at http://www.rockefellerfoundation.org/uploads/files/2b053b2b-8feb-46ea-adbd-f89068d59785-impact.pdf
6 Goldman Sachs. GS Social Impact Fund. Available at http://www.goldmansachs.com/our-thinking/focus-on/impact-investing/touts/fact-sheet.pdf

Early childhood programs are an excellent prospect for PFS financing, since many of them have been documented to provide long-term social and economic benefits. Examples of such services include home visiting programs, child care programs, pre-kindergarten programs for three- and four-year-olds, early intervention programs for children with developmental delays, and programs to strengthen families.



At the moment, PFS is better developed in other fields, notably recidivism reduction, homelessness, juvenile justice, and workforce development. Still, there have been starts on PFS in early childhood. For instance, Utah recently announced a Social Impact Bond to provide prekindergarten for up to 3,500 three- and four-year-olds, with the goal of preventing unnecessary special education. The SIB will measure (and base payment on) special education avoided through sixth grade. Its backers are Goldman Sachs and the venture capitalist J.B. Pritzer; United Way is the payor, with the county chipping in.[7]

In addition, requests for information or proposals show that other states are looking into PFS to scale up early childhood services:

- South Carolina has issued a request for information to help plan a PFS deal to improve maternal and child health outcomes.[8]
- New York issued a request for proposals for one or two PFS transactions that the state will fund for up to $30 million, with early childhood listed as one of several potential focus areas.[9]
- Connecticut has issued a request for information for a PFS to help children and families in the child welfare system who are affected by substance abuse.[10]

Benefits of PFS for early childhood programs

Over the long term, PFS financing could prompt a broad shift in how resources are allocated in early childhood programming: away from responding to crime, educational failure, and health problems and toward programs that prevent these problems and put children on the path to success.

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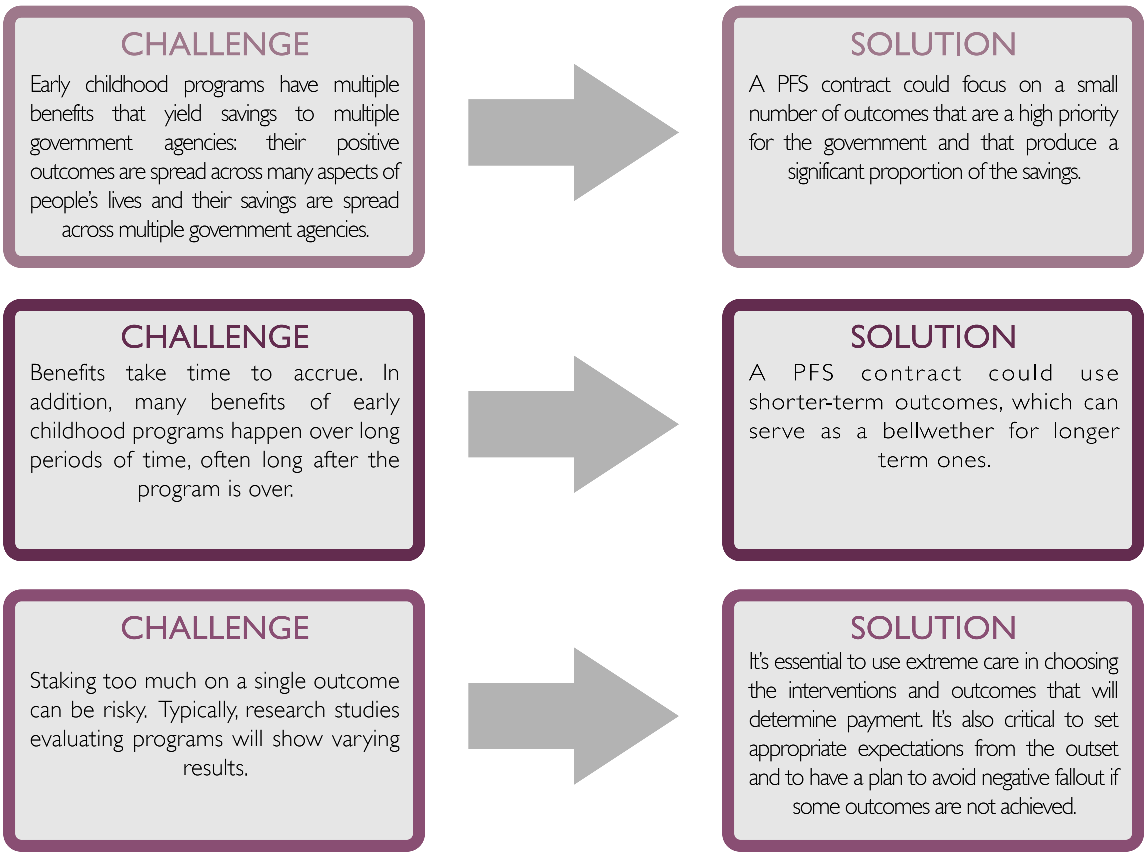
In addition to its benefits for providers, government, investors,

7 See http://www.goldmansachs.com/what-we-do/investing-and-lending/urban-investments/case-studies/impact-bond-slc-multimedia/fact-sheet-pdf.pdf
8 See https://www.scdhhs.gov/sites/default/files/Social_Impact_Bond_RFI_%231.pdf
9 See http://www.budget.ny.gov/contract/pfs/rfp_PFS.html
10 See http://www.ct.gov/dcf/lib/dcf/socialimpactbonds/pdf/ctsib-rfi-november2013.pdf

and communities, PFS financing will help early childhood interventions increase their impact on children and families. Despite good intentions, tracking outcomes is hard and very few programs do it. PFS financing provides the incentive and funding to build this capacity. When programs monitor their outcomes, they take steps to better understand and improve them.

(potential challenges)

Nevertheless, there are several challenges to keep in mind in pursuing PFS.



CHALLENGE: Early childhood programs have multiple benefits that yield savings to multiple government agencies. A factor that makes early childhood programs so valuable also presents a challenge for obtaining government funding: their positive outcomes are spread across many aspects of people's lives and their savings are spread across multiple government agencies. A single early childhood intervention might yield benefits to the health, education, and justice systems. Compare the issue of reducing recidivism, for instance: its benefits (and savings) accrue mainly to the justice system. Since governments generally budget by agency, any individual government agency may be reluctant to commit significant funds for a program that produces benefits and savings for other agencies, or even other levels of government.

> SOLUTION: A PFS contract could focus on a small number of outcomes that are a high priority for the government and that produce a significant proportion of the savings. For instance, a PFS project to scale up the Nurse-Family Partnership could base payment on maternal and health outcomes, which are of great importance to the state and which produce a significant proportion of the program's savings. Another solution is for a government entity with responsibility for the jurisdiction's budget as a whole—like Massachusetts's Department of Administration and Finance—to take the lead on early childhood PFS financing.

CHALLENGE: Benefits take time to accrue. In addition, many benefits of early childhood programs happen over long periods of time, often long after the program is over. For example, it will take many years to see the effect of a program on children's future school performance or even earnings. This makes it hard to monitor outcomes or to use them as a basis for payment. In addition, many investors can't wait more than four to six years to get a return.

SOLUTION: To get around this issue, a PFS contract could use shorter-term outcomes, which can serve as a bellwether for longer term ones. It could pick one or two outcomes that are especially important, as above, even if those outcomes themselves do not generate enough savings in the short term to cover the full cost of scaling up the program. In areas other than preventive social services, governments frequently allocate resources to policies and programs that benefit society in the long run even if they are not fully funded by short-term savings, so government's committing funds to achieve important outcomes would not be out of the ordinary. And it is government's promise to pay that attracts outside investors.

CHALLENGE: Staking too much on a single outcome can be risky. Typically, research studies evaluating programs will show varying results. Some studies show strong outcomes in one area but not another, while other evaluations of the same program in a different location might show different results. If a provider stakes too much on a single outcome, which is then not achieved, there is a danger that the wider audience of government funders, potential investors, and philanthropies will conclude that it is not worth investing in that intervention or even in early childhood interventions more broadly.

SOLUTION: In all PFS transactions, it's essential to use extreme care in choosing the interventions and outcomes that will determine payment. It's also critical to set appropriate expectations from the outset and to have a plan to avoid negative fallout if some outcomes are not achieved. In addition, while consistently effective programs are still being developed and tested, government and other funders should consider financing mechanisms that do not bet everything on achieving a small number of specific outcomes. Instead, they could create incentives for particular outcomes through bonuses, for instance. This method does not stake too much on a single result. Alternatively, foundations could finance innovative programs on a Pay for Success basis, since, unlike investors, they may be more willing to assume the risk inherent in launching new programs; Government can then agree to pay for specific outcomes should they be achieved.

(how ready is the early childhood field for PFS?)

PFS financing currently focuses on programs that already have substantial evidence documenting their effectiveness in producing the desired outcome. That's because private investors are unlikely to invest in programs without such evidence. The risk would be too great.

> "Many worthy early childhood programs simply cannot satisfy private investors. It's possible that in the future, as PFS becomes more established, private investors (and government) will be more willing to invest in programs with a smaller evidence base. But today the number of candidates for PFS remains small."

Obviously, all organizations in the early childhood field want to improve outcomes for the children they serve. But only a small number of programs in this field—indeed, in any field—can produce this kind of evidence.

Why do many early childhood programs lack the evidence currently required for PFS financing? Often they are small or community based, with limited resources. But even large organizations may have funding streams that neither require nor provide for evaluations, the needed computer systems, model development, or planning for replication. Rigorous evaluations are not only very expensive; they are also very difficult to fund. And while a strong evidence base is an essential element for providers interested in PFS, it's hardly the only requirement: they must also have strong performance management systems, willing funders, and many other characteristics to be suitable for this financing mechanism.

So for now, many worthy early childhood programs simply cannot satisfy private investors. It's possible that in the future, as PFS becomes more established, private investors (and government) will be more willing to invest in programs with a smaller evidence base. But today the number of candidates for PFS remains small.

What does this mean for early childhood providers? They should still be encouraged by the growing interest in PFS, even if they are not good candidates for it right now. The momentum for this financing mechanism is driving several changes that can have a great impact on the field as a whole, as well as on providers individually. All programs can benefit from more attention to outcomes and evaluation. Moreover, the momentum is accelerating the creation of PFS models beyond SIBs that may be simpler and more within reach of providers still new to managing their outcomes and developing the appropriate capacities.

In other words, even though most providers are not ready for PFS right now, it would behoove them to act as though they will someday pursue PFS financing. By doing so, they will improve outcomes for the people they serve, position themselves for the full range of financing by outcomes, and prepare themselves to access new capital in the future.

(moving forward: securing more Pay for Success financing for early childhood interventions)

“We must ask, *How can we help more early childhood providers access Pay for Success financing to support preventive programs?*”

Although most early childhood programs are not yet ready for PFS financing, this new method does appear to hold great promise for the field.

So we must ask, *How can we help more early childhood providers access Pay for Success financing to support their preventive programs?*

There are many potential steps, outlined below. It bears repeating, however, that whether or not a provider ultimately receives PFS financing, pursuing these steps will have a positive impact on its efforts and outcomes.

The first step for all providers is to conduct a feasibility analysis to determine their level of readiness. A feasibility study should address these questions:

1. Which outcomes are you confident the program will achieve?
2. What savings/benefits do those outcomes produce? To which agencies?
3. What will scaling look like? How many people will be served? How much will it cost?
4. Do the benefits/savings exceed the costs?
5. Is there a government agency (or agencies) willing to pay for the outcomes?

There are different ways to do this:

- *An internal analysis.* This is what the Children's Aid Society did as it considered various options for a SIB to fund services for children in the juvenile justice system. CAS wrote a detailed case study on its process and the lessons it learned, *Developing A Social Impact Bond: Lessons From a Provider.*[11]
- *A more formal analysis that engages stakeholders and builds support.* The Institute for Child Success used this approach in evaluating the suitability of PFS for early childhood programming in South Carolina. See *Using Pay for Success Financing to Improve Outcomes for South Carolina's Children: Results of a Feasibility Study.*
- *Analysis in partnership with a PFS intermediary organization.* A few organizations in the United States specialize in working with various parties to construct PFS deals; they may also contract with investors, the government, and providers to implement the deal. Examples are Social Finance U.S. and Third Sector Capital Partners. These organizations often work with providers that are strong candidates for PFS financing to prepare them for PFS financing opportunities.[12]

What happens next depends on whether or not the provider already has a strong evidence base for the outcomes of its services.

Steps for programs with an already-strong evidence base

1. Talk to foundation funders to determine their interest in outcomes-based management and PFS financing. Ideally, secure support for a PFS planning phase.
2. Gather evidence of outcomes, return on investment, cost savings, numbers of people who can be served, expansion plans, and cost for specific jurisdictions.
3. Monitor and respond to government PFS solicitations; engage with government agencies from jurisdictions that do not already have PFS procurement under way to interest them in PFS funding.
4. Connect with intermediaries, which can in turn connect with potential funders.

11 Children's Aid Society. Developing A Social Impact Bond: Lessons From a Provider January 2013. Available at http://www.childrensaidsociety.org/files/upload-docs/CAS_FINAL_Report.pdf

12 Institute for Child Success. Using Pay for Success.

Steps for programs that are not yet candidates for PFS

If the study shows that a provider does not yet have the evidence and capacity demanded of the first generation of PFS transactions involving outside investors, it should pursue these steps:

1. Talk to foundation funders to determine their interest in outcomes-based management and PFS financing. Ideally, secure support for building capacity.
2. Take steps to build capacity such as
    - Specifying outcomes and ways of measuring them
    - Developing baseline measures for the outcomes
    - Developing capacity and data sharing agreements to monitor outcomes regularly
    - Partnering with researchers to plan and seek funding for rigorous evaluations.

Steps for the sector as a whole

By the sector we mean the full mix of funders, government agencies, and investors, plus providers, collectively.

1. *Analyze how PFS financing would apply to each part of the early childhood sector.* ICS explored PFS for a home visiting program and the Utah SIB targets pre-K. Now that these first forays have been completed, governments, providers, and funders would benefit from more analysis of how PFS applies to other early care and education programs, early intervention programs for children with developmental delays, and programs to strengthen families. Then they should engage stakeholders in discussing possibilities and obstacles and planning a path forward.
2. *Government and philanthropic funders should fund capacity building for early childhood services.* The goal is an enhanced ability to monitor outcomes and expand programs' reach. Funders as well as providers will benefit from what is learned. What's needed:
    - Defining outcomes, ways to measure them, and baselines
    - Building the capacity to monitor them
    - Clearly defining program models, developing the capacity to scale up with fidelity to the models, and developing tools to predict the costs of expansion.
3. *Invest in research to develop more effective programs and to rigorously evaluate the programs that appear to be working.* Examples include
    - *Frontiers of Innovation* This program at Harvard's Center for the Developing Child brings together researchers, policy makers, practitioners, philanthropists, and other experts to develop research-based programs to help vulnerable children.[13]
    - *The Coalition for Evidence-Based Policy* This group has shown that rigorous evaluations can be done inexpensively in its report *Rigorous Program Evaluations on a Budget: How Low-Cost Randomized Trials are Possible in Many Areas of Social Policy.*[14]

13 Frontiers of Inniviation web page: http://developingchild.harvard.edu/activities/frontiers_of_innovation/
14 Coaltion for Evidence-Based Policy. Rigorous Program Evaluations on a Budget: How Low-Cost Randomized Trials are Possible in Many Areas of Social Policy. March 2012. Available at http://coalition4evidence.org/wp-content/uploads/Rigorous-Program-Evaluations-on-a-Budget-March-2012.pdf

(conclusion)

Pay for Success holds great promise for scaling up early childhood interventions. As this new financing method becomes more established, and as more providers develop the evidence base and evaluation measures that will attract funders, we can expect more PFS deals to be struck. All providers, whether or not they secure PFS financing, will benefit by devoting greater attention to outcomes and evaluation.

“Pay for Success holds great promise for scaling up early childhood interventions. As this new financing method becomes more established, and as more providers develop the evidence base and evaluation measures that will attract funders, we can expect more PFS deals to be struck.”

And more children will benefit from greater access to proven programs that can enhance their health, behavior, learning, and economic prospects. ICS believes that PFS can play an important role in improving the future of our most vulnerable children. We are excited to see growing interest in this new financing mechanism.

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The Institute for Child Success is a non-profit, non-partisan research and policy organization that fosters public and private partnerships to align and improve resources for the success of young children in South Carolina. A partnership of the Children's Hospital of the Greenville Health System and the United Way of Greenville County, ICS supports service providers, policy makers, and advocates focused on early childhood development, healthcare, and education to build a sustainable system that ensures the success of all children, pre-natal through age five.