

## The Opportunity

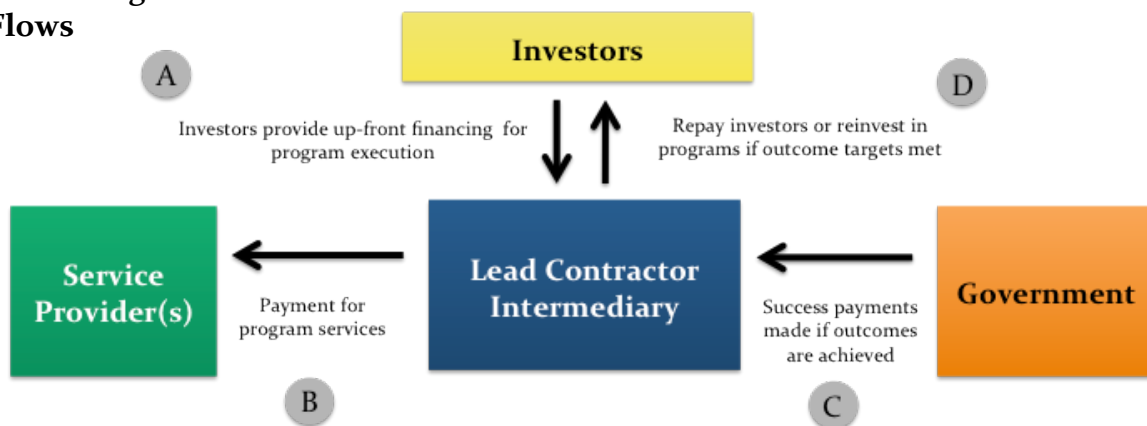
Each year, the U.S. spends billions of dollars on social programs that fail to achieve measurable impact. At the same time, there are limited funds to grow programs with documented results. Pay for Success programs, when combined with innovative social financing mechanisms, present opportunities to create unique public-private partnerships to redirect resources towards preventative initiatives that measurably improve lives.

## What is Pay for Success?

**Pay for Success** is a general term for performance-based contracting between government and social service providers. Under these programs, impact is measured rigorously and government makes “success payments” only when results are achieved, as opposed to up front. The focus on rewarding accomplishment of specific outcomes, rather than paying for services to be performed, helps ensure that incentives are properly aligned to achieve social impact at the lowest possible cost.

**Social Innovation Financing mechanisms** support Pay for Success programs by providing advance capital to implement preventative programs before success payments are made to a project. Financing capital can be raised from philanthropic or private sources, some of which may seek a modest return on investment. Success payments can be used to pay back initial investors, or can be reinvested into the project, allowing further growth. “Social impact bonds” are one type of social innovation financing mechanisms.

## Pay for Success Program Financial Flows



Source: Liebman, Jeffrey. Social Impact Bonds. Center for American Progress. 2011

## Pay for Success Mechanics

Pay for Success/Social Innovation Financing constructs are framed around several key principles:

1. Government, lead contractors and investors **agree on targeted outcomes** for a societal dilemma – for example, reducing recidivism or homelessness.
2. Government and lead contractor enter a **multi-year contract**, in which the government agrees to pay lead contractor if targeted outcomes are achieved.
3. Private and philanthropic investors **provide the necessary up-front capital** to lead contractor to fund the program.
4. Lead contractor orchestrates the delivery of the social intervention via subcontracts with service providers.
5. An independent evaluator **monitors performance** against agreed-upon benchmarks.
6. Lead contractor receives government payments only if targeted social outcomes are achieved, then repays investors or reinvests in programs.

## Benefits

- Repositions government spending from remedial programs to cost-effective, impactful preventative programs
- Attracts new forms of capital to the social sector
- Shifts nonperformance risk from government to investors
- Independent evaluation creates transparency for all parties
- Creates opportunities to reinvest in successful programs

## Risks

- Nonperformance of lead contractor or service providers
- Lack of clarity and/or ability to measure social outcomes
- Non-rigorous evaluation methodologies
- Lack of government data for cost-effective evaluations
- Insufficient rate of return for funders and provider

## About Third Sector Capital Partners

At Third Sector Capital Partners, we are guided by the principle that all communities deserve the opportunity to thrive. We believe in the importance of bringing high-performing, evidence-based social innovations to scale, in a way that is financially sustainable.

Our mission is to *deliver financial solutions that will accelerate America's transition to an evidence-based social sector.*

Third Sector provides a variety of advisory services to governments, funders, service providers, and project intermediaries interested in exploring Pay for Success and Social Innovation initiatives, using a customized and collaborative approach.

Our services include:

- **Transaction Advisory Services**, including program feasibility assessment, program risk evaluation and partnership formation
- **Deal Construction**, including financial structuring, fundraising/capital arrangement and vetting of partnership stakeholders
- **Post-Closing Intermediary Services**, including fiscal agency, investor relations and evaluation advisory services
- **Education and Advocacy Services**, to advance the development of a performance-driven social sector

## Examples of Our Work



On August 1, 2012, the Commonwealth of Massachusetts announced that it had selected Third Sector Capital Partners to develop two groundbreaking Pay for Success pilot programs. Massachusetts was the first state in the nation to issue a competitive process to obtain services using social innovation financing. Third Sector will serve as lead intermediary for a youth recidivism initiative and as partner with Corporation for Supportive Housing & United Way of Massachusetts Bay & Merrimack Valley to the Massachusetts Housing & Shelter Alliance, lead intermediary for a chronic homelessness project.



Since November 2011 Third Sector Capital Partners has been actively advising Cuyahoga County, Ohio, as the county government works to build its own Pay for Success initiative. Third Sector has helped convene and educate numerous stakeholders, including service providers, representatives of the philanthropic community, government officials, and community members. Third Sector's technical assistance services have included due diligence, economic modeling, and project structuring.

## Contact

**George Overholser** introduced the concepts of Pay for Success and Social Innovation Financing at New Profit's Gathering of Leaders in 2007 and has been a longtime advocate for smarter social investing. He was on the founding management team of Capital One Financial Corporation and was Co-Founder of North Hill Ventures.  
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**Rick Edwards** brings extensive experience in structuring public-private partnerships from his time as Global Head of Project Finance and Advisory for JP Morgan Chase, where he built #1 market share for the division.  
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**Caroline Whistler** previously worked at Nonprofit Finance Fund Capital Partners, and brings five years of experience in innovative social financing for high-performing nonprofits.  
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### **Ingredients of a Pay for Success Pilot:**

- **Government leadership** to address and spearhead a public/private innovation
- **Social needs** that are sizable, unmet and high-priority
- **Target populations** that are well defined and can be measured with scientific rigor
- **Administrative data** that is credible, readily available, and inexpensive to collect
- **Interventions** that are highly likely to achieve impact
- **Proven service providers** that can scale with quality
- **Cost-effective programs** that can demonstrate fiscal savings for government
- **Safeguards** to protect the well-being of constituents

### **Promising Pay for Success Opportunities**

Addressing Homelessness • Reducing Recidivism  
Dropout Prevention • Workforce Development  
Improving Foster Outcomes • Preventative Health Care  
Early Childhood Education