Authorizing Pay for Success Projects

A Legislative Review and Model Pay for Success Legislation

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I. Introduction

Pay for Success ("PFS") is a model for deploying government resources that drives funding toward social programs that prove effective at providing results to people with the most need. Under a PFS model, government agrees to pay for a service contingent on the program having measurable impact. If there is no impact, government does not pay. Impact funders and philanthropists provide the funds to pay for program delivery while impact is being evaluated and bear the risk that there will not be any proven impact. PFS initiatives have garnered substantial media attention, with the focus primarily on the innovation, the intervention and parties themselves.

Despite the rapidly growing interest in Pay for Success contracting in the United States, little attention has been given to the enabling environment, including regulatory policy. The regulatory situation, principally state and local legislation, is an essential yet overlooked component of these interventions. Given the direct impact, predominance and progress of state- and local-level PFS legislation, this paper[1] focuses on state and local legislative initiatives, analyzing the choices legislative bodies should consider when drafting and revising PFS legislation. We analyze history, enactment, and primary features across jurisdictions. We then offer legal and policy recommendations for lawmakers considering future PFS legislation, based on the following key questions:

- Should legislation be PFS-specific or should the State rely on general contracting authority?
- Should legislation be focused on a specific transaction or rather serve as a general grant of authority?
- Should the PFS contract result in a general obligation of the State?
- Should a sinking fund be included?
- Should legislation require cost savings within a particular timeframe or focus instead on resource allocation?
- Should legislation require outcome based payments or provide greater flexibility?
- Should an evaluation be required?

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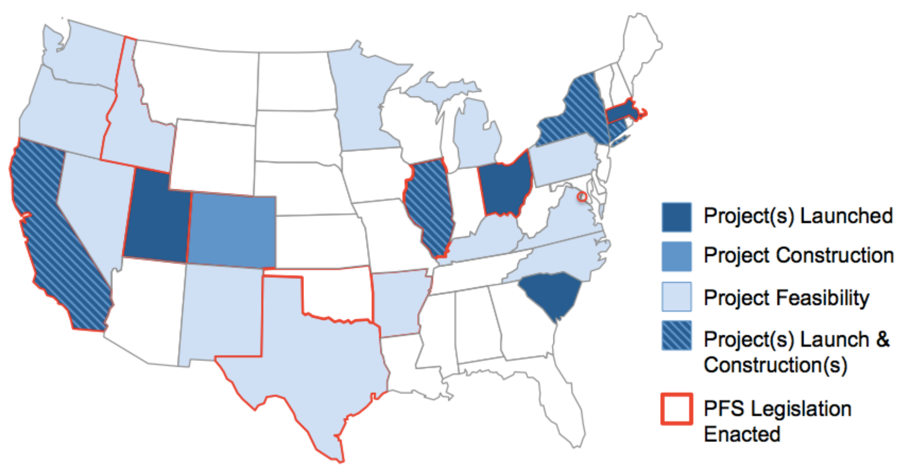
II. Pay for Success Overview

PFS is taking off nationally. As of February 2016, eleven PFS projects have launched in nine jurisdictions across the U.S., beginning with New York City's Recidivism Reduction Initiative in 2012.[2] PFS projects exist in Democratic- and Republican-leaning jurisdictions, encompassing diverse issue areas, such as recidivism, early childhood education, and chronic homelessness. As of February 2016, we estimate that there are in excess of 20 in development across the U.S.[3] The Sorenson Impact Center, a Division of David Eccles School of Business, University of Utah, estimates that 39 states have project feasibility studies, many of which may lead to newly-launched projects in the near future.[4]

III. Introduction to PFS as a Legislative Phenomenon



Of the eleven U.S. PFS projects, seven operate under a state or local legislative framework. In other cases, states have opted to rely on existing contract authority. PFS legislation can accomplish two important objectives in PFS transactions. First, legislation can enable governments to enter into multi-year contingent contracts, thus mitigating contract enforceability uncertainty. Second, since states appropriate funding through either annual or bi-annual budgets, legislation can offer security to potential funders by mitigating the risk that governments will fail to appropriate funds for the project. Multi-year funding security plays a key factor in mitigating funder concern.

As of February 2016, eleven jurisdictions have enacted PFS legislation. In 2012, Massachusetts became the first state to enact enabling legislation,[5] which has so far provided overarching authority for two PFS projects in the state.

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[2] Press Release, N.Y.C. Office of the Mayor, *Mayor Bloomberg, Deputy Mayor Gibbs and Corrections Commissioner Schriro Announce Nation's First Social Impact Bond Program*, available at http://tinyurl.com/j8aj4yo.

[3] See e.g., Third Sector Capital Partners, http://www.thirdsectorcap.org/projects/; Sorenson Impact Center, http://www.policyinnovationlab.org/pay-for-success/.

[4] Sorenson, http://www.policyinnovationlab.org/pay-for-success/.

[5] Mass. Gen. Laws ch. 10, § 35VV (2012); H.R. 4219, 189th Gen. Ct., Reg. Sess. (Mass. 2012).

Seven states, as well as the District of Columbia, have since joined Massachusetts, in addition to other units of local government, including Cuyahoga County and the City of Chicago. 2015 has been the most substantial year for state-level PFS legislation. Eleven states introduced legislation authorizing PFS transactions and four states (Colorado, Texas, Idaho, and Arkansas) enacted it into law.[6] At the federal level, PFS-related companion bills have also been introduced, including in the SIF Bill, HUD authorization, 2012 DOL, and Hurricane Sandy relief legislation[7]. Progress at the local, state, and federal level suggest substantial promise in the bipartisan nature of these legislative efforts - of the eleven jurisdictions that have enacted PFS legislation, six leaned Democrat in the 2012 presidential election, while five leaned Republican.

The legislation varies in the mandates' scope. Some jurisdictions provide a broad scope, not specifying sectors or structures. Massachusetts, for example, adopted a broad mandate. Legislation authorized PFS projects "to improve outcomes and lower costs for contracted government services," encompassing the breadth of government procurement.[8] Colorado and Texas have adopted similarly broad approaches.[9] Other jurisdictions, narrowly tailor the legislation to authorize particular interventions and strategies. For example, Oklahoma authorized PFS transactions only in the context of "criminal justice programs that have outcomes associated with reducing public sector costs".[10] Arkansas and California PFS legislation applies exclusively to programs that reduce re-incarceration rates.[11] In Idaho and Utah, only PFS projects involving certain educational services have been authorized;[12] while in Chicago, only a particular intervention was authorized.[13]

A lack of PFS enabling legislation complicates, but does not prevent, the state or municipalities from entering into PFS contracts. While more complicated, existing multi-year contracting authority provides a template to pursue PFS contracts. One practical consideration, however, is that the lack of PFS legislation may signal a potential lack of buy-in from parties within the state and thus decrease funder confidence in the contract.

The balance between broad, narrow, or no authorization must be a judgment call of the legislature. Broad authorization vests substantial authority in executive agencies, allowing the state to pursue interventions based on a range of identified needs. Narrow authorization focuses state action on specific issues, but may have the effect of catalyzing a range of interventions in the identified sector, solving structural issues more quickly. While states may enter into PFS contracts without specific legislative authorization, the lack of legislative support may limit the ability to attract funders and to coral relevant state actors.

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[6] NFF Pay for Success Learning Hub, http://www.payforsuccess.org/pay-success-deals-united-states.

[7] Evidence-Based Policymaking Commission Act of 2015, H.R. 1831, 114th Cong. (2015); Social Impact Partnership Act, S. 1089, 114th Cong. (2015); Social Impact Partnership Act, H.R. 1336, 114th Cong. (2015); Pay for Performance Act, S. 2691, 113th Cong. (2013); Social Impact Bond Act, H.R. 4885, 113th Cong. (2013).

[8] Mass. Gen. Laws ch. 10, § 35VV (2012).

[9] Colorado's law creates a state pay for success contracts program with the purpose to "provide authorization . . . for the office to enter into pay for success contracts with one or more lead contractors for the provision of social services" (State of Colorado House Bill 15-1317); Texas' law is similarly broad, not specifying any particular type of service provision.

[10] Oklahoma SB 1278.

[11] Arkansas SB 472; California AB 1837.

[12] Idaho HB 170; Utah 15-1317.

[13] City of Chicago Pay-For-Success Ordinance, available at http://www.payforsuccess.org/sites/default/files/o2014-8677.pdf (focusing on pre-kindergarten programs for at-risk children).

IV. Choices for State and Local Lawmakers

Based on our experience, lawmakers exploring PFS legislation should address the following questions. Where appropriate, we also include a recommendation.

- **Should your jurisdiction have specific PFS legislation?**
  - **Yes**. PFS legislation creates an expectation that performance-based, multi-year contracts are an acceptable method of social service provisions. As a result, legislation provides the opportunity to engage in creative social service delivery partnerships that aim to address underlying structural issues as well as bring more funding to the table.
  - **No.** The state is concerned with limiting social service delivery methods or concerned about the perception of social service delivery privatization. As PFS contracts bring private funders to the table, depending on the political climate, this could be a concern for legislatures.
  - **Key Question.** How enforceable are multi-year contingent contracts without specific legislation in your jurisdiction? If this type of contract is not enforceable, then PFS legislation is likely to be required in order to engage in this type of activity. If this type of contract is enforceable, then broad or specific PFS legislation may serve as a catalyst to enter into this type of contract.

- **Should you pursue specific-purpose legislation or a general grant of authority?**
  - **Recommendation**: A general grant of authority. Broad-based PFS legislation provides flexibility to pursue interventions determined to be necessary by parties engaged in social service delivery. Instead of constricting the type of activity able to be pursued under PFS contracts, legislation should grant authority to the relevant executive branch agencies to determine the best method to meet a variety of social needs.

- **Should you make the PFS contract a General Obligation of the State?**
  - **Recommendation:** Yes, if possible. Making the PFS contract a General Obligation of the State undoubtedly helps bring funders to the table and provide a greater guarantee for repayment. It is, however, likely not feasible in many instances, and only one state – Massachusetts - has pursued this course to date.

- **Should you create a sinking fund?**
  - In many jurisdictions, the legislation creates the ability or even an expectation that funds will be appropriated on an annual basis and set aside in a "sinking fund" reserved for the making of success payments. Sinking funds may be structured as receiving an annual allocation or as receiving one lump sum allocation. Annual allocations increase the uncertainty that the fund may be funded in any given year whereas a lump sum payment guarantees longer-term payment.[14]

[14] See Include a Sinking Fund in "Main Provisions" chart below.

- **Recommendation:** Yes. While not the only method to fund PFS contracts, a sinking fund provides greater certainty to funders and provides the legislature a consistent and separate source of funding for innovative social service strategies. In addition, in states without PFS legislation, sinking funds are a valuable tool for facilitating multi-year, contingent contracts. At the same time, it should be recognized that a sinking fund requires identifying funding sources during the delivery of services under the PFS contract, with the jurisdiction only recovering those funds at the end of the project if outcomes are not achieved.

- **Do you require savings?**
  - Some legislation requires that the PFS program deliver savings – that the PFS funded intervention in some sense costs the jurisdiction less than alternative programming.[15]

  - **Recommendation:** We recommend that the focus of any required savings should be on the more efficient use of government resources, instead of so-called cashable savings.[16] Cashable savings requires being able to show that a funded preventive intervention – such as an anti-recidivism program -- costs less than the existing alternative – such as imprisonment. While many programs do lend themselves to such an argument, others do not. An alternative, and we believe better, focus is to ask whether the PFS program will lead to greater efficiency, to greater taxpayer value? For example, will tying payments in a workforce development program to actual placement of participants in jobs cost the government less per outcome than paying based on the number of people who participate in the program. An additional question to ask is what type of timeframe savings should be required within. Given that the results of PFS interventions will likely not be visible until at least partway through the initiative and often not for years to come, any resource efficiency analysis should be aligned with that timeframe.

- **Should you require outcome-based payment?**
  - **Recommendation:** Yes. Outcome-based payment is core to the definition of PFS contracts. The legislation should assure that the outcomes are rigorously defined, including an advanced determination of who defines the outcomes. Determining appropriate outcomes in advance of the start of the intervention is a key aspect of PFS contracts.

- **Should you require an evaluation?**
  - **Recommendation**: Yes. An independent evaluator will help provide consistency and authority to PFS contracts and provide a third-party guarantee of effectiveness.

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[15] See Government determination that the PFS project will create savings in "Main Provisions" chart below.

[16] For "improved taxpayer value" examples, see e.g., Pay for Success Act, S.B. 472, 90th Gen. Assemb., Reg. Sess. (Ark. 2015), Ark. Code Ann. § 12-27-204 (requiring that any PFS contract "will result in specific performance improvements and budgetary savings if the performance targets are achieved") and Social Innovation Financing Program, A.B. 1837, 2013-14 Leg., Reg. Sess. (Cal. 2014). (requiring that PFS contracts must demonstrate "significant performance improvements [and] budgetary savings if the performance targets are achieved").

V. Major Features and Implications of State-Level PFS Legislation

Contractual Requirements

While PFS contractual requirements vary across states, recurring examples of PFS legislative terms include the following:

Main Provisions		
Provision	**Number of States**	**States**
Condition payments on the achievement of outcomes	8	Arkansas; California; Colorado; Idaho; Massachusetts; Oklahoma; Texas; Utah
Requires evaluation	8	Arkansas; California; Colorado; Idaho; Massachusetts; Texas; Idaho; Utah
Requires all PFS contracts to include payment schedule	6	Arkansas; California; Colorado; Massachusetts; Texas; Utah
Include a Sinking Fund/Account	1	Massachusetts
Government determination that the PFS project will create savings	5	Arkansas; California; Colorado; Massachusetts; Texas

Miscellaneous Provisions		
Provision	**Number of States**	**States**
Contract term limit	1	Texas
Termination rights	2	Colorado; Idaho
Restriction on PFS program participants	1	Arkansas
Source of funds/matching requirement	1	California
Annual audit requirement	1	Idaho
Identify distribution of savings	1	Idaho
Conditions precedent to execute PFS contract	3	Idaho; Oklahoma; Texas

VI. Conclusion

PFS legislation provides states a streamlined process to enter into PFS contracts. Rather than limiting the type of interventions a state may pursue to support its citizens, well-crafted PFS legislation expands the scope of possible interventions, providing the ability to engage additional public and private partners to enact change to address structural as well as immediate needs of citizens. Any state looking to pursue PFS legislation must address a number of key questions, some of which are detailed above. No one model of PFS legislation is necessarily optimal; however, understanding the options and crafting the appropriate model for your jurisdiction will help create an environment enabling the government to support meaningful, measured, and justified social action.

Appendix A. List of all Local, State, and Federal Bills

I. FEDERAL

Legislation	Link
Every Student Succeeds Act, S. 1177, 114th Cong. (2015) (enacted).	http://www.payforsuccess.org/sites/default/files/BILLS-114s1177enr.pdf
FAST Act, H.R. 22, 114th Cong. (2015) (enacted).	http://www.payforsuccess.org/sites/default/files/BILLS-114hr22enr.pdf
Workforce Innovation and Opportunity Act, H.R. 803, 113th Cong. (2013-2014) (enacted).	https://www.gpo.gov/fdsys/pkg/BILLS-113hr803enr/pdf/BILLS-113hr803enr.pdf

II. STATE AND LOCAL

State/Local Jurisdiction	Legislation	Link
Arkansas	Pay for Success Act, S.B. 472, 90th Gen. Assemb., Reg. Sess. (Ark. 2015), Ark. Code Ann. § 12-27-204.	ftp://www.arkleg.state.ar.us/Bills/2015/Public/SB472.pdf
California	Social Innovation Financing Program, A.B. 1837, 2013-14 Leg., Reg. Sess. (Cal. 2014).	http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201320140AB1837
Chicago	Loan Agreement and Contract With IFF Pay for Success I LLC, Chicago SIB Authorizing Ordinance (Oct. 8, 2014).	http://www.payforsuccess.org/sites/default/files/o2014-8677.pdf
Colorado	Pay for Success Contracts, H.B. 15-1317, 70th Gen. Assemb, Reg. Sess. (Colo. 2015).	http://www.leg.state.co.us/clics/clics2015a/csl.nsf/fsbillcont3/B86272F9E2CFBB2087257DB10065DBB2?Open&file=1317_enr.pdf
Cuyahoga County, Ohio	Social Impact Financing Fund Ordinance, Cuyahoga Cty., Ohio Ordinances, No. O2014-0018 (2014), Cuyahoga Cnty. Code § 715 (2014).	http://www.thirdsectorcap.org/wp-content/uploads/2015/03/O2014-0018.pdf
District of Columbia	Pay for Success Contract Fund, D.C. Law 20-155 (Act 20-424), 20th Council Sess. (D.C. 2014); D.C. Code § 2-211.03.	http://dccouncil.us/files/user_uploads/related_materials/21DCSTAT_Q1.pdf
Idaho	Pay for Success Contracts-	https://legislature.idaho.gov/legislatio

State/Local Jurisdiction	Legislation	Link
	Education, H.B. 170, 63rd Leg., 1st Reg. Sess. (Idaho 2015), Idaho Code Ann. § 33-125B (2015).	n/2015/H0170.htm
Massachusetts	Social Innovation Financing Trust Fund, H.R. 4219, 189th Gen. Ct., Reg. Sess. (Mass. 2012), Mass. Gen. Laws ch. 10, § 35VV (2012).	https://malegislature.gov/Content/Documents/Budget/FY2013/ConferenceReport-H4219.pdf https://malegislature.gov/Bills/187/House/H4219
Oklahoma	Pay for Success Revolving Fund-Criminal Justice, S.B. 1278, 54th Leg., 2nd Reg. Sess. (Okla. 2014), Ok. Stat. Ann. tit. 57 § 510.8c (2014).	http://www.payforsuccess.org/sites/default/files/sb1278_enr.pdf
Texas	Pay for Success Contracts, H.B. 3014, 84th Leg. Sess. (Tex. 2015), Tex. Gov't Code § 403.110 (2015).	http://payforsuccess.org/sites/default/files/84r_hb_3014_-_enrolled_version_-_bill_text.pdf
Utah	School Readiness Initiative Act, H.B. 96, 2014 Gen. Sess. (Utah 2014), Utah Code Ann. § 53A-1b-101 et seq. (2014).	http://www.payforsuccess.org/sites/default/files/hb0096.pdf