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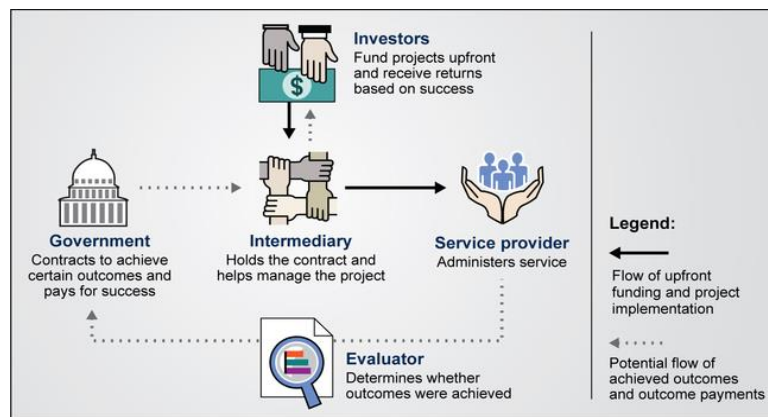
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Pay for Success and Social Impact Bonds

Background

PFS/SIB Model¹



Source: GAO analysis. | GAO-15-646

As federal funding for non-defense, discretionary spending continues to decline, many communities and lawmakers from across the country are turning to pay-for-success (PFS) programs, also known as Social Impact Bonds (SIBs), as a means to finance solutions to social problems. As stated by The White House, “PFS financing is an innovative model that leverages philanthropic and private dollars to fund preventive services, which are provided by nonprofits and other non-governmental entities up front, with the government paying only when services generate measurable results that meet pre-specified targets. By structuring payments around measurable outcomes, PFS financing can provide greater flexibility for State, local, and tribal governments to implement evidence-based solutions, carefully test promising innovations, and scale programs that work.”²

There is no size limitation on a successful PFS/SIB model, however several key players must be included. According to the Government Accountability Office (GAO), a PFS/SIB project is basically a complex set of contracts between multiple organizations working together to deliver social service programs....

¹ [“Pay For Success: Collaboration among Federal Agencies Would be Helpful as Governments Explore New Financing Mechanisms”](#), Government Accountability Office Report, Sept. 2015

² The White House. 2015. [“Improving Outcomes through Pay for Success.”](#)

Although individual PFS projects may vary in terms of roles and responsibilities for the parties to the contract, there are five main types of organizations that commonly participate in a PFS project: government, intermediaries, investors, service providers, and evaluators (See above Illustration).” The GAO defines each PFS organization’s role, as follows:

- **Government** originates a contract for defined outcomes and pays on the basis of those outcomes being achieved.
- **Investors** provide capital to finance a program. They provide capital on the condition that the government will repay the investment if outcomes are achieved, usually with a rate of return. In U.S. projects to date, capital has been provided by a mix of investor types, such as banks, foundations, and high-net-worth individuals.
- **Intermediaries** enter into a government contract in a PFS project and usually receive a fee for the services they provide. Intermediaries can take on a variety of roles in a PFS project, such as providing technical support to governments on the feasibility of a project, identifying the service provider, raising operating funds from investors, negotiating the terms of contracts or agreements with governments, service providers, and investors; disbursing payments to service providers; and overseeing day-to-day performance management of the project.
- **Service providers** enter into contracts with an intermediary or a government to administer the evidence-based prevention program. Examples of service providers that have been involved in PFS projects include nonprofit or charitable organizations with established track records of implementing programs in specific policy areas, such as job training or homelessness prevention.
- **Evaluators** measure a program’s outcomes or evaluate a program’s effect on the target population. The evaluator’s work assures the other participating organizations that defined outcomes were achieved and are likely due to the program, rather than to other factors, including chance. Outcome payments are based on these findings.

In the United States, the wide use of PFS/SIBs is still in its early stages. Currently the federal government is interested in using PFS/SIBs to transition projects from their initial experiment or demonstration stages to scalable programs. This work requires a rigorous selection and evaluation process, as well as adequate funding, which is increasingly scarce for new programs. However, the White House and Congress have made proposals to expand federal support for PFS/SIB projects. Members of Congress have introduced legislation on PFS/SIB to expand federal support for projects. The President’s 2016 budget also proposed PFS demonstration programs in several federal agencies, including HUD.

PFS/SIBs for Multifamily Housing

HUD and the White House are working together to implement an Energy Efficiency Pay for Success Model, which is intended to deliver energy savings at federally assisted properties at little to no cost to the taxpayer. Generally, if a private owner of multifamily housing completes energy improvements to their properties, the associated financial savings flow to HUD since the Department subsidizes the utility expenses. HUD wants to overcome the lack of upfront public capital and barriers to private capital participation while improving the energy efficiency of 20,000 units in multifamily properties.

Legislation had been introduced to permit this pay-for-success model. Under the Private Investment in Housing Act of 2015, introduced by Representative Dennis Ross (R-FL) in July of this year, HUD may

enter into budget-neutral, performance-based contracts for energy and water conservation improvements for multifamily residential units. Up to 20,000 units may participate in the demonstration. The energy savings payments made by HUD to private investors under this law would be based on a measurement and verification protocol that includes:

- Establishment of a weather-normalized and occupancy-normalized utility consumption baseline established pre-retrofit;
- Annual third-party confirmation of actual utility consumption and cost for utilities;
- Annual third-party validation of the tenant utility allowances in effect during the applicable year and vacancy rates for each unit type.

Some examples of the envisioned upgrades under this law include adding insulation, replacing drafty doors and windows, and updating inefficient light and water fixtures.

The Private Investment in Housing Act of 2015 has gained sweeping bipartisan support and passed the House of Representatives five days after its introduction with a recorded vote of 395 to 28. It did not pass in the Senate, but on November 4, House Financial Services Committee Chairman Jeb Hensarling (R-TX) offered an amendment to a large transportation bill which included the same provisions included in the Private Investment in Housing Act. The transportation bill was passed by Congress on Dec. 3, 2015.

Many state governments are also beginning to use social impact bond financing to create pay-for-success projects to manage local issues. In Washington, the state Health Care Authority was one of three organizations chosen in a national competition run by Third Sector Capital Partners, Inc. and supported by a grant from the Corporation for National and Community Service's Social Innovation Fund. With this \$15,000 grant, the Washington State Health Care Authority is assessing the feasibility of using a PFS model to provide persons residing in institutional settings with the opportunity to transition to community-based supportive housing. The Healthcare Authority is aiming to provide better healthcare and lower costs for residents of health care institutions who prefer to live in a community setting.

The White House has also been promoting the use of PFS and SIBs as a method to eliminate homelessness. In a blog [post](#) from October of this year, the Administration cited the county of Santa Clara, CA as a model example for other communities to implement a PFS/SIB program. The County determined that it would need permanent supportive housing to address chronic homelessness. However, Santa Clara was only willing to pay for the housing projects once positive outcomes were achieved, so the county needed someone to cover the provider's costs of service delivery. They found impact investors willing to take on the risk, including Google, which was willing to take on the "no-interest" investment through its charitable foundation. Other philanthropic and charitable supporters include the Reinvestment Fund, the Irvine Foundation and the California Endowment. A total of \$6.9 million was invested in Santa Clara's plan.

Under the PFS model, the county will only repay investors if the housing service improves housing stability beyond a predetermined level of impact. To do so, Santa Clara sought out an independent evaluator to assess whether the housing program measurably improves health, social service utilization outcomes and the level of savings for local government. The University of California, San Francisco will perform the evaluations with assistance from technology partner Palantir, which is helping make data tracking cheaper and faster so program participants can learn quickly and course-correct as

needed. Through its PFS housing program, Santa Clara will serve up to 200 chronically homeless people in the county.

Conclusion

The PFS/SIB models are an exciting example of public-private partnerships that can be fostered in the absence of direct government funding. Currently, there are at least seven projects across the country that are enabling local governments to contract for new services.

While NAHMA remains a steadfast advocate and supporter of more traditional funding models for housing, we also support the innovative efforts of PFS/SIB projects. These initiatives can be a tool to address social problems, like increasing the availability of affordable units while demonstrating the life-enriching qualities of stable housing.