Center for American Progress

Fact Sheet: Social Impact Bonds

A Brief Introduction to a New Financing Tool for Social Programs

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What is a Social Impact Bond?

Social Impact Bonds turn government funding structures on their head. Normally, government agencies fund tightly proscribed *activities*. In a Social Impact Bond, however, a government agency defines an *outcome*. The agency contracts with an external organization that promises to achieve that outcome and only pays the organization if it is successful.

Who are the key players?

Required:

- A *government agency* that defines the outcome
- An *external organization* that promises to deliver the outcome
- A *beneficiary population* who receives services

Optional:

- *Investors* who fund the needed interventions upfront
- *Service providers* who perform the interventions

Where's the "bond"?

There isn't one. When the external organization needs outside investors to fund service providers, "bond" can describe the relationship between the external organization and the investors. But the arrangement is not very bond-like. In fact, it's much more risky than a normal bond arrangement. And in cases where there aren't any outside investors, it's very difficult to identify any "bond" at all.

It's easiest to think of a Social Impact Bond instead as a relationship between government and an external organization.

What are the advantages of Social Impact Bonds?

1. Social Impact Bonds transfer risk away from government and taxpayers. Government isn't on the hook for the payment if the outside organization fails to achieve the outcome. In a normal financing arrangement, if the initiative fails the money is already spent.

2. Social Impact Bonds can fund preventive services that will save government money down the road.

3. Social Impact Bonds can overcome the "silo" problem in government where agencies find it difficult to pool resources or direct money toward effective programs.

4. Social Impact Bonds can help to "scale up" effective interventions from one city or state to other areas of the country.

The first Social Impact Bond: Peterborough prison

It's easiest to understand Social Impact Bonds with an example.

In the United Kingdom, the British government has promised to pay an external organization called Social Finance if it reduces the re-offending rate of prisoners leaving Peterborough prison. The government will pay Social Finance so long as there is a 7.5 percent measured reduction in recidivism relative to a group of similar prisoners discharged from other prisons.

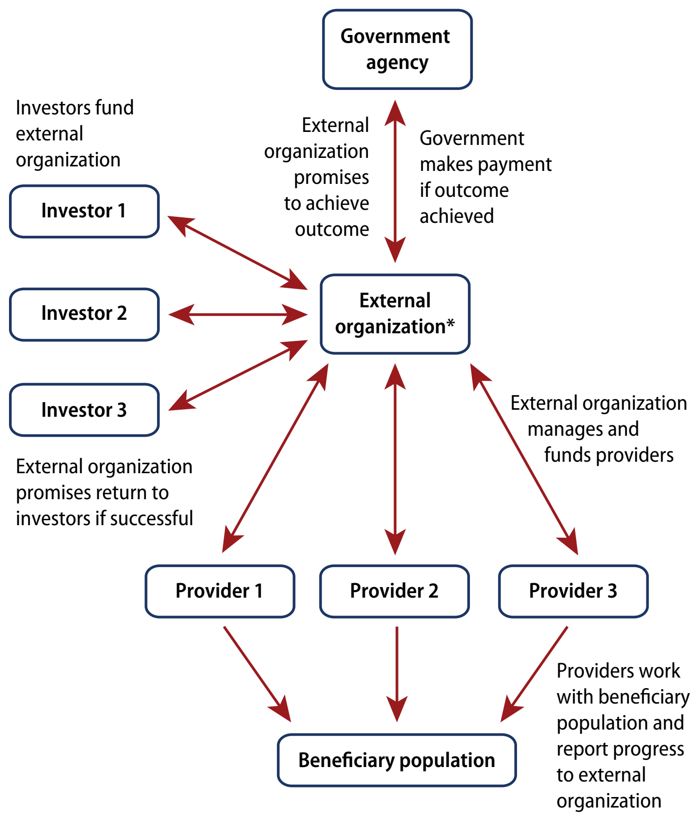
Social Finance needs funds to pay for interventions in advance of any payment from the government, so it has raised money from investors. In exchange for paying the upfront costs, these investors receive an agreed-upon return if the outcome is achieved.

The British government calculated how much it is willing to pay for the outcome by looking at the savings likely to accrue to government agencies over time as a result of reductions in re-offending. These include future savings in incarceration costs as well as in court and police time.

FIGURE 1

The Peterborough-style social impact bond

First such program focuses on reducing re-offending rates of prisoners



*There are several appropriate variations on the Peterborough-style Social Impact Bond. The external organization may raise funds from its own balance sheet rather than from outside investors. The external organization also may choose to be one of the service providers, or the sole provider, for the intervention.

Where will Social Impact Bonds be useful?

Social Impact Bonds are still in their infancy, and there remains a great deal to learn. But some areas that governments in the United States are exploring for Social Impact Bonds include:

- Reducing recidivism
- Reducing homelessness
- Preventive health services
- Workforce development
- Early childhood education
- Helping unemployed persons re-enter the workforce

Early applications of Social Impact Bonds will most likely be in areas where a few criteria hold true. First, government agencies may reasonably believe they will *save money* from the outcome. Outcomes will likely be *observable and measurable* within three to eight years. Outcomes will be targeted in areas with *known social interventions* that have proven effective at achieving the outcome. Finally, Social Impact Bonds should not be used to provide core government services, so there are *few negative consequences* if the external organization cannot achieve the outcome and discontinues services.

But Social Impact Bonds have much wider implications for all government programs and may encourage agencies to focus more on *outcomes* rather than *activities*.

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