



Program Funding and Financing

Pay for Success Early Childhood Education
Toolkit Report #4



What Is Pay for Success?

Pay for success (PFS) offers an alternative approach to investing in the future, including early childhood education. This innovative financing mechanism shifts financial risk from a traditional funder—usually government—to a new investor, who provides up-front capital to scale an evidence-based social program to improve outcomes for a vulnerable population. If an independent evaluation shows that the program achieved agreed-upon outcomes, then the investment is repaid by the traditional funder. If not, the investor takes the loss.

For more information on pay for success, please visit pfs.urban.org.



About the Early Childhood Education Toolkit

This toolkit is designed to guide jurisdictions and their partners through the core elements of a PFS project in early childhood education: the existing evidence for early childhood interventions, the role of data, the measurement and pricing of outcomes, program funding and financing, implementation, and evaluation design. The toolkit includes checklists, charts, and questions for consideration, to help direct and clarify thinking around the feasibility of pay for success to scale what works in early childhood education. Together, these briefs can help jurisdictions decide if pay for success is the right approach for them—and if so, how to get started.



Acknowledgments

The Pay for Success Early Childhood Education Toolkit was conceived by a working group led by the Urban Institute and its partners at the fifth annual Clinton Global Initiative America meeting in 2015 in Denver, Colorado.

The Urban Institute is incredibly grateful to our working group partners, who lent their time and talents to the development, research, and writing of this toolkit: Accenture, Bank of America Merrill Lynch, Enterprise Community Partners, Goldman Sachs, the Institute for Child Success, Nonprofit Finance Fund, The Reinvestment Fund, Salt Lake County, Social Finance US, and Third Sector Capital Partners.

Support for the Pay for Success Initiative at the Urban Institute is provided by the Laura and John Arnold Foundation. We thank our funders, who make it possible for Urban to advance its mission.

The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders. Funders do not determine research findings or the insights and recommendations of Urban experts. Further information on the Urban Institute's funding principles is available at www.urban.org/support.



Program Funding and Financing

For this **program funding and financing report**, we are particularly grateful to Anna Fogel and Casey Littlefield (Social Finance); Caroline Moreno and Fraser Nelson (Salt Lake County, UT); Jennifer Auerbach-Rodriguez and Dash Boyer-Olson (Bank of America Merrill Lynch); Ben Nichols and Caroline Wagner (Enterprise Community Partners); and Albert Wong (Third Sector Capital Partners).

Identifying reliable revenue streams for repaying PFS project funders is critical to attracting the up-front capital that shifts risk away from government. To secure both private and philanthropic investors, governments must ensure they can repay funders throughout a project's life as outcomes are met and success payments come due. Different funders—given their different motivations for becoming involved in PFS—will be willing to tolerate different levels of risk and, therefore, may require different safeguards against a failure to repay according to the terms of the contract.

This report describes program funding in early childhood PFS projects, with a focus on early childhood education. It is part of a larger toolkit for states, localities, and investors considering early childhood PFS projects. Its content is based partly on stakeholders' experiences with ongoing PFS projects.¹

First, we describe funder incentives for entering a PFS contract. We consider key questions about structuring repayments, including considerations about who will be the outcome payers and how governments can provide funds for repayments. We then describe strategies for mitigating appropriations risk, such as placing repayments into sinking funds or escrow accounts, or running a one-year ramp-up or pilot period. Last, we discuss considerations for passing PFS-specific legislation and the optimal size of a PFS contract.



What Is the Problem with Funding for Early Childhood Education?

Finding consistent, adequate funding for early childhood education (ECE) programs can be challenging at all levels of government. Although state and local preschool funding has grown substantially in recent years, per-child spending remains low relative to K–12 education programs (Barnett et al. 2016; Parker, Atchison, and Workman 2016). Several factors help explain this trend:



ECE programs are discretionary, not entitlements. They are susceptible to budget cuts in lean fiscal times, and appropriations can fluctuate from year to year. As a result, ECE programs are often underfunded.



Unlike with K–12 programs, provision of ECE programs is generally voluntary nationwide. Although some states and cities are working toward universal access, providing adequate services is often difficult. Families may be unaware of ECE options, and some locations may not have enough qualified providers or physical spaces to support additional investments. Service provision often differs across a state, meaning access depends on factors outside family control.



The benefits of ECE programs accrue over a long time horizon. Governments may find it difficult to justify investments in ECE over programs with more immediate returns (ICS 2014).



The benefits of ECE programs accrue to many systems, often outside ECE.

This wrong pockets problem² means that costs to public agencies funding a program may outweigh the benefits, resulting in sustained suboptimal investment despite potential long-term benefits. For example, a preschool program that reduces crime later in life will reduce costs for criminal justice systems rather than ECE systems (Kay and Pennucci 2014).

Given that ECE programs are often underfunded, governments may not have the revenue to create new programs or increase investments in current programs. Therefore, PFS may be an avenue to expand promising ECE programs and generate evidence that can motivate new revenue for ongoing programming.

How Does Government Pay for ECE Programs?

The landscape of state and local ECE funding streams is complex and siloed, and it varies greatly across jurisdictions. While localities usually run ECE programs, multiple federal, state, and local sources may provide funding. Consistent funding for ECE programs comes from several streams:



Head Start and Early Head Start: Local nonprofit, for-profit, and public agencies and school systems receive funds from the federal government through Head Start and Early Head Start to provide early education systems for eligible low-income children

from birth to age 5. The US Department of Health and Human Services provides the grants, which are administered by the Office of Head Start. The federal government provided \$8.3 billion in fiscal year 2014 for services for children under 5 years old. In addition, during the 2014–15 school year, states spent an additional \$164 million on supplemental funding for Head Start prekindergarten programs for 3- and 4-year-olds (Barnett et al. 2016).



State prekindergarten programs: In 2015, 42 states and the District of Columbia invested in state-funded and state-designed prekindergarten services. Funded separately from federal Head Start programs, these programs are typically administered by state departments of education and primarily serve 3- and 4-year-olds; most states target lower-income children or children at risk of school failure. In the 2015–16 school year, state funding for pre-K programs totaled \$6.2 billion (Barnett et al. 2016).



Individuals with Disabilities Education Act (IDEA): The federal IDEA Preschool Grants program provides formula grants for early intervention, special education, and related services to children ages 3 through 5. The US Department of Education, Office of Special Education Programs, gives IDEA grants to states that serve all eligible children with disabilities ages 3 through 5 and have an approved application under Part B of the IDEA. All states make free public education available to all children ages 3 through 5 with disabilities. Funds are distributed to eligible entities through a formula based on general population and poverty.³



Federal Child Care and Development Fund (CCDF): Child care subsidies help low-income families with children under age 13 pay for child care through vouchers. Families can use vouchers with a provider of their choice. States have significant flexibility in setting policies for CCDF; funds come to states as block grants, so states may fund providers that offer preschool effectively.



Other: Other federal funding sources for preschool programs include funding from Temporary Assistance for Needy Families, funding from Title I of the No Child Left Behind Act, and other federal programs like the Child and Adult Care Food Program and Early Childhood in Department of Defense Education Activity. Many programs also receive funding from local governments. In addition to publicly funded programs, private child care centers and preschools enroll many children.⁴ Some governments are partnering with philanthropies, the business community, nonprofits, and intermediaries to create new service delivery systems for ECE, such as Prosperity 2020 in Utah.⁵

State and local governments may raise additional capital for preschool programs by

appropriating funds from general revenues, providing local matching funds, or generating revenue through lotteries or sin taxes. To cope with underfunding, jurisdictions and individual providers often blend and braid⁶ federal, state, and local sources to generate enough capital for their programming needs. Blending and braiding add complexity to early education because funding streams can have different eligibility requirements, quality standards, and required accountability mechanisms (Wallen and Hubbard 2013).

How Can PFS Bring New Capital into ECE?

Pay for success projects offer the potential for new investment in public early childhood education beyond traditional public funding and ad hoc gifts and grants.

PFS projects are funded in two ways: up-front capital and outcomes repayment. **Up-front capital** is the funds invested in a PFS project from the start to cover the costs of service delivery and project management, including the evaluation. Private funders, philanthropic funders, other groups such as community development investment funds, or a combination of funders can provide up-front capital. Funding may be in the form of equity, loans, program-related investments, or recoverable grants (TeKolste, Hawkins, and Eldridge, 2016).

Repayment describes how, when, and under what circumstances a government returns capital to project investors based on results from an independent evaluation. The government entity responsible for repayment is referred to as the outcome payer. PFS projects to date have used a range of repayment structures that include different outcome metrics and repayment triggers. Selecting the best outcome metrics for repayments is covered in depth in toolkit report #3, *Outcomes Measurement and Pricing* (Rohacek and Isaacs 2016).

The remainder of this report covers funding and repayment in PFS ECE projects (box 1). We outline stakeholder incentives for participating in PFS projects, considerations for states and localities when deciding how to provide funding for repayments, and strategies for mitigating **appropriations risks**. We then detail considerations for passing PFS-specific legislation and the optimal size for a PFS contract.

BOX 1

GLOSSARY

- *Appropriations risk: The risk that the government will not fulfill its obligation to repay investors.*
- *Outcome payer: The government entity responsible for repayment to investors if the program is successful.*
- *Repayment: How, when, and under what circumstances a government returns capital to project investors, based on results from an independent evaluation.*
- *Up-front capital: The funds invested in a PFS project from the start to cover the costs of service delivery and project management, including the evaluation.*

What Are Funder Incentives for Entering a PFS Contract?

Private and philanthropic funders face different incentives for funding a PFS project.



Private investors may be motivated to invest in PFS if high-net-worth individuals demand impact investing from their wealth management services to fulfill their corporate social responsibility activities or to generate positive public relations. Private funders seek a return on investment from PFS, although that may be a secondary motivation. In some previous projects, funders have prioritized repayment that ensures principal repayment rather than enhanced returns (Fogel, Shumway, and Udpa 2015). So far, PFS projects have required significant philanthropic support to mitigate risk for private investors (TeKolste, Hawkins, and Eldridge 2016).



Philanthropic investors' incentives differ based on the organization and issue area addressed through PFS. Some may be impact investors seeking a “double bottom line” of both financial return and measurable social impact,⁷ while others may not expect an a return on investment (Goldman Sachs, n.d.). PFS funding can have a much greater impact than what philanthropic dollars achieve normally; because multiple investors are involved, philanthropies can be part of much larger projects. Philanthropies can further increase their impact by recycling recouped funds for other projects. Beyond scale, philanthropies may be drawn to PFS because of interest in program evaluation and evidence, alignment with their organizational mission, a desire to build capacity, interest in impact investing outside traditional

grantmaking activities, interest in program-related investment, and/or geographic and policy interests (Archer-Rosenthal 2016; Fogel, Shumway, and Udpa 2015; Rangan and Chase 2015).



Other investors: Like many philanthropic funders, community development financial institutions (CDFIs) and impact investing vehicles view PFS projects as a way to achieve a double bottom line. Some may also see PFS as an extension of current work in community development financing, Community Reinvestment Act investing, low-income housing, new markets tax credit investing, or pooled investment funds (Archer-Rosenthal 2016).

The Chronic Homelessness Pay for Success Initiative in Cuyahoga County illustrates the role philanthropy can play in PFS. The project is financed entirely by philanthropic dollars, with most funding coming from Reinvestment Fund, a CDFI. Subordinate loans come from Nonprofit Finance Fund, another CDFI, and three foundations. In other projects, such as the South Carolina Nurse-Family Partnership Project, philanthropy provides all the funding. As the PFS market develops, the stakeholder incentives outlined above may shape iterations of the model. However, while PFS remains somewhat bespoke, future projects will likely continue to rely on philanthropic support to absorb some risk, thus attracting private capital (box 2).

BOX 2

WHY NEW SOURCES OF CAPITAL MAY BE CONSIDERED LOWER RISK

Service providers may perceive certain funders as having lower or higher risk profiles, and these perceptions influence their decision to participate in a PFS project. In particular, new sources of capital—which can supplement, rather than replace, traditional funding—are generally perceived as lower risk.

*Sam Schaeffer from the Center for Employment Opportunities (CEO)—the service provider in the New York State PFS project—articulated this perspective in an online article for the **Stanford Social Innovation Review**:*

Who are the investors in the deal? This matters. One of our interests in participating in a PFS project was accessing new forms of financial support that were previously unavailable to CEO. A high-risk scenario would be if existing government and/or philanthropic support were diverted into a PFS deal. We are loathe [sic] to cannibalize existing funders. The low-risk option was attracting entirely new capital to participate in the deal. In future deals, I could envision CEO accepting the medium-risk scenario, but for our first deal, it would have been a deal-breaker to go past the low-risk scenario.^a

^a Sam Schaeffer, "Assessing Nonprofit Risk in PFS Deals," July 31, 2014, http://ssir.org/articles/entry/assessing_nonprofit_risk_in_pfs_deals.

How Can Governments Structure PFS Repayments?

Because every jurisdiction is different, there is no single blueprint for structuring repayment in a PFS project. However, state and local governments have several considerations when deciding how to structure repayment to investors in an early childhood education PFS project:

- Who will pay for the outcome(s)?
- How can government allocate funds for PFS repayments?
- How can repayments be structured to mitigate risk?
- Does government need to pass legislation to authorize all or part of the project?

The following sections will address these questions, including key considerations to help jurisdictions navigate the full options surrounding funding PFS projects in ECE.

Who Will Pay for the Outcome(s)?

The first step in structuring repayments in a PFS project is identifying an outcome payer, or the party responsible for making payments to the funders. An outcome payer may be one or more government agencies (e.g., the Connecticut Department of Children and Families), a local or state government (e.g., the City of Chicago), or another government-affiliated entity such as a local or state board of education. PFS projects have so far included one or two outcome payers, reflecting that more than one organization often accrues value from the outcomes social programs generate.

Because selecting outcome payers requires commitment from political leadership and political will, PFS stakeholders should begin to identify an outcome payer as early as possible during project development. Key considerations inform the government's choice of outcome payers:

- Did the idea to pursue a PFS project come from a specific government agency? If not, which entities are most interested in PFS?
- Which entity is most interested in the outcomes associated with the intervention?
- Which entity is accruing the greatest benefit (including potential cost savings) from the intervention?
- Which entity has the budgetary flexibility to consider a potential repayment?
- Are any entities experiencing the wrong pockets problem, or seeing increased use or costs?
- Does government anticipate any future service gaps, necessitating increased capital today?

- Which potential outcome payers are willing and able to cooperate with multiple parties across government, philanthropy, and the private sector?
- Which potential outcome payers have access to administrative data?

Selecting outcome payers for ECE PFS projects may present additional challenges because of the long time horizon associated with many expected outcomes and the subsequent benefits and cost savings. If current political leaders will not see benefits accrue to their constituents until after they leave office, for example, they may be less motivated to participate in a project. Strategies for mitigating policy risks are discussed in toolkit report #5, *Project and Performance Management* (Derrick-Mills, Kreeger, and Massey, 2016).

One strategy to address this challenge is using short-term or interim outcomes as proxies for long-term benefits. Although this strategy is not without its challenges—evidence for proxies is more limited—it can be useful when most impressive results are longer term. For example, the Chicago PFS project uses third-grade literacy, as measured through a nationally administered third-grade reading test, as one outcome for repayment. Analysts have used similar test results to predict or act as a proxy for high school graduation (WSIPP 2016). Selection of outcomes is discussed in depth in toolkit report #3, *Outcomes Measurement and Pricing* (Rohacek and Isaacs 2016).

How Can Government Allocate Funds for PFS Repayments?

Once an outcome payer is selected, governments have to decide where funding to repay investors will come from. This decision varies based on factors including the outcome payer's revenue streams and the laws and regulations governing those funding sources.

The challenges inherent in getting a government to commit to potential repayments years down the line—even if the savings and benefits eclipse the costs—are significant. For this reason, buy-in at all levels of government is generally a prerequisite for launching any PFS project.

Options for appropriating funds for PFS repayments include the following:

- **General funds, annual or multiyear.** A government in charge of repayment may appropriate annual or multiyear funding from its general budget. General budgets often have flexibility in how their funds can be spent, and that can sometimes obviate the need for PFS-specific legislation. In Santa Clara, California, annual PFS appropriations are part of the county baseline budget.

- **Dedicated funding stream.** A government may reallocate part of a discretionary funding stream dedicated to supporting the issue area associated with the PFS intervention. Salt Lake County, for example, dedicated funds available through the continuation of a jail bond to two PFS projects focused on criminal justice reform.
- **Sinking fund or set-aside account.** A government may appropriate (in whole or in part) back-end payments into a sinking fund.⁸ This fund may be guaranteed by an investor, or, as with one PFS project in Massachusetts, by the state. This option is explored in more detail in the next section.
- **Escrow account.** Governments may create an escrow account for PFS repayments. Governments may also pay part of a PFS project up front and deposit the rest in a matching escrow account guaranteed by an investor. The Chicago PFS project places its annual appropriations in an escrow account.

There is no right answer for choosing a PFS funding stream for repayment. Governments should consider the following when deciding which funding stream is the best fit:

- **Blending and braiding.** Many ECE programs are supported by blended or braided funding sources. Blending and braiding comes with challenges, including coordination across agencies, fluctuations in funding from some sources, and differing requirements that come with the funding.
- **Legal barriers.** Depending on local context and the intervention being scaled, some funding streams may be accessible without additional authorizing legislation, while others may not be. Jurisdictions should consider what forms of repayment are legal based on federal, state, and local laws.
- **Mitigation of appropriations risk.** Many repayment structures are designed partly or fully to mitigate risk for both governments and investors, including appropriations risk. Depending on the relative risk tolerances of the parties involved, different structures may be more or less desirable.
- **Political considerations.** Political considerations, such as upcoming administrative transitions or priorities favored by the current administration, may factor into decisions about which funding streams are most appropriate.

How Can Repayments Be Structured to Mitigate Risk?

PFS projects are risky not only because they use a new financing mechanism, but also because investing in social outcomes is inherently uncertain; no matter how rigorous the evaluations behind a program, there is no way to predict its results with full confidence. Further, evaluation results are difficult to generalize, even when a program has a strong evidence base, because that evidence may not translate to a new place and population. Governments must also decide if repayments will be “all or nothing,” or if they will make some repayments even if all project goals are not met.

Governments have two primary considerations when structuring repayments: designing repayments that reflect program outcomes and structuring repayments to mitigate appropriations risks. Toolkit report #3, *Outcomes Measurement and Pricing* (Rohacek and Isaacs 2016) discusses the first consideration in detail, so this report will focus on the second.

Of all the risks faced in a PFS project, appropriations risk is especially critical for funders. Jurisdictions may consider the strategies in table 1 to mitigate appropriations risk.

TABLE 1

Strategies for Mitigating Appropriations Risk

STRATEGY	BENEFITS	FUNDER PERCEPTION	EXAMPLE
Backing by the full faith and credit of the issuing municipality	Such backing makes the appropriations risk of PFS financing as close to debt securities instruments (e.g., bonds) as possible. This setup is ideal for private investors because governments have a financial and reputational incentive to make their payments.	Lowers risk for all funders	Massachusetts established the Social Innovation Financing Trust Fund backed by the full faith and credit of the commonwealth to ensure repayments in PFS projects.
Sinking funds and escrow accounts	Sinking funds and escrow accounts increase investor confidence by guaranteeing back-end payments in whole or in part from the start of a project.	Lowers risk for all funders	Utah places annual appropriations for repayment in an escrow account.
Layered capital stack with senior and junior lenders (subordinate debt)	Unlike traditional subordinate lending structures, in which senior lenders have their capital repaid first but receive a lower rate of return, in PFS projects, junior lenders agree to both a lower rate of return and receiving their capital second. Government may repay senior and junior lenders for different outcomes, or junior lenders may receive payment only after senior lenders are repaid in full. As the field develops, the role of junior lenders may change, so they are compensated for the additional risk they take on.	Lowers risk for senior funders, provides junior lenders (often philanthropies) opportunity to earn return on investment	Goldman Sachs is a senior lender for the Utah High-Quality Preschool Program, investing \$4.6 million. The J. B. and M. K. Pritzker Family Foundation is the junior lender, investing \$2.4 million. Both investors will receive a 5 percent rate of return. Senior loans are repaid annually from years 3–10, and subordinate loans are repaid only after senior investments.



TABLE 1, continued

Strategies for Mitigating Appropriations Risk

STRATEGY	BENEFITS	FUNDER PERCEPTION	EXAMPLE
One-year pilot or ramp-up testing periods	Ramp-up periods allow project partners to operationalize and refine systems. To mitigate risk for senior funders, philanthropic funders may provide up-front capital for the ramp-up; senior funders would be involved only after project partners improve on the first year of operation. Ramp-up periods can occur before or after formal project launch. ^a	Lowers risk for senior funders	The Chicago project launched after a one-year service ramp-up period.
Interim repayments	For investors, receiving multiple payments decreases the risk of not receiving the full amount in the expected time frame. For governments, interim repayments help fund the project in subsequent years by staggering repayment and lowering the cost of capital. Interim repayments may be especially useful in early childhood education PFS projects as proxy measures for outcomes that occur beyond the project time frame.	Lowers risk for all funders	In Utah, special education outcomes are reported yearly and tied to success payments.

Sources: Authors.

^aDana Archer-Rosenthal, *Pay for Success: The First Generation* (New York: Nonprofit Finance Fund, 2016). http://www.payforsuccess.org/sites/default/files/Pay%20for%20Success_The%20First%20Generation_0.pdf.

Does Government Need to Pass Legislation to Authorize All or Part of the Project?

PFS represents a departure from business as usual in government contracting. Therefore, jurisdictions may need to pursue either state or local legislation to authorize the multiyear, outcomes-oriented contracts PFS requires. Legislation may also be needed to authorize sinking funds or other methods of mitigating appropriations risk. Further, legislation can signal buy-in from a state’s governing body (Teicher, Grossman, and Chong 2016).

State and local governments may use existing multiyear contracting authority to pursue PFS instead of passing legislation. This option avoids the possibly burdensome and time-consuming legislative process, but it may also be more complex when governments are not accustomed to contracting for outcomes. Whether the benefits of legislation outweigh the effort to get it passed will depend on local context (box 3).

Legislation can be either broad or narrow, and costs and benefits are associated with each choice (Teicher, Grossman, and Chong 2016). Broad legislation gives executive agencies substantial authority, allowing the government to pursue interventions that address a wide range of societal challenges. This approach can be particularly suited to jurisdictions in which

multiple agencies oversee ECE programs. Narrow legislation limits the government to specific issues but may also concentrate resources to one sector and therefore solve problems more quickly.

Six PFS projects are currently operating under state legislation,⁹ and 11 jurisdictions had enacted PFS legislation as of February 2016. Third Sector Capital Partners identifies the following key questions for lawmakers considering PFS legislation (Teicher, Grossman, and Chong 2016):

- Should legislation be PFS specific, or should the government rely on general contracting authority?
- Should legislation be focused on a specific transaction or serve as a general grant of authority?
- Should the PFS contract result in a general obligation of the government?
- Should a sinking fund be included?
- Should legislation require cost savings within a particular time frame or focus instead on resource allocation?¹⁰

In addition to these questions, lawmakers may consider whether legislation will specify target outcomes or a target intervention. For example, PFS legislation introduced in New Hampshire would, if passed, specifically authorize PFS projects to scale prekindergarten.¹¹

BOX 3

THE STORY OF UTAH'S PAY FOR SUCCESS LEGISLATION

In 2013, PFS legislation failed to pass the Utah state legislature. PFS stakeholders determined that they would have more success if they could demonstrate the program worked through a yearlong proof of concept. United Way of Salt Lake advanced \$1 million for the first cohort of students, and the Salt Lake County Council contributed \$350,000. This funding was enough to pay back investors for the first cohort of students through sixth grade. Legislation finally passed at the state level in 2014, and the State of Utah subsequently assumed responsibility for the remaining four cohorts. The bill, HB 96, created the School Readiness Board in the governor's Office of Management and Budget, and gave the board the authority to enter into results-based financing contracts with private entities, along with a \$3 million ongoing appropriation.⁹

⁹ Utah School Readiness Initiative, HB 96, 2014 Leg., Gen. Sess. (Utah 2014), <http://le.utah.gov/~2014/bills/static/hb0096.html>.

Chicago stakeholders decided not to pursue PFS legislation. Instead, the project involves the nonprofit CDFI Illinois Facilities Fund as a fiscal intermediary and project coordinator. As a fiscal intermediary, Illinois Facilities Fund borrows money from the funders, lends money to the City of Chicago, and arranges repayments from the city to the funders. This arrangement required approval from the Chicago City Council and the Chicago Board of Education, but it did not require state legislation.

What Is the Optimal Size for a PFS Contract?

Although government and investor motivations for contract size differ, both parties may prefer larger PFS contracts. However, the current budgeting process typically limits project size because governments do not want to overestimate future allocations.

Because transaction costs for governments are sometimes higher in PFS projects than in direct contracting, larger projects that serve more constituents are perceived as more efficient. If a state organizes a PFS project, the government must also serve enough constituents to have a statewide impact, which is easier with a larger contract.

For some investors, concerns about the size of a PFS contract are motivated by institutional mandates. For example, commercial and community lenders may have a floor for the size of their investments. Investors may also have requirements for cash-on-cash returns¹ that smaller projects cannot meet.

Some philanthropic investors may be less concerned with the size of a project, as their contributions are typically smaller and the scale of even a small PFS project is significant compared with business as usual. Others may be focused on broader systems change, and therefore may prioritize large projects accordingly.

Though desirable, large PFS contracts present challenges for governments and service providers. First, governments must guarantee that they can recruit and enroll enough individuals to meet the goals of a large project. Second, some of the most promising evidence-based practices are also costly, so a successful PFS project must balance the goal to serve more people with the real cost of an intervention. Third, because many local and state governments are strapped for cash, they cannot realistically set aside large sums of money for repayment, even with up-front support from investors. Finally, nonprofit service providers must be able to scale services to the size of a project. These issues should all be considered and discussed early in the process, such as during a feasibility study (see toolkit report #5, *Project and Performance Management*).

Conclusion

For PFS to work as intended, governments must secure adequate up-front funding from private and philanthropic investors and must structure repayments to those funders in a way that sufficiently mitigates risks. The considerations identified here can guide stakeholders in their efforts to structure PFS program funding. Subsequent toolkit reports provide more detailed information on program implementation and evaluation design.



Notes

¹ In 30- to 60-minute interviews, we asked eight stakeholders (including Urban experts, intermediaries, government officials, legal experts, and private funders) about PFS program funding. They described their motivations for participating in PFS, as well as their experiences structuring repayments and considering and passing PFS legislation.

² The wrong pockets problem describes a situation in which the entity that bears the cost of implementing a practice does not receive a commensurate benefit. Because the costs outweigh the benefits for that implementing entity, projects in the public interest are underresourced. Thus, project investment is suboptimal, as is social welfare—in equilibrium (Roman 2015).

³ “Preschool Grants for Children with Disabilities,” US Department of Education, last modified May 5, 2016, <http://www2.ed.gov/programs/oseppsg/funding.html>.

⁴ Clare McCann, “Child Care,” EdCentral (blog), New America Foundation, <http://www.edcentral.org/edcyclopedia/child-care/>.

⁵ Prosperity 2020 is a strategic investment by Utah’s business community in pre-K–12 education. The program’s investment plan targets educational tools, assessment technologies, teacher compensation, and financial assistance for low-income students (“Prosperity 2020,” Salt Lake Chamber of Business, <http://slchamber.com/prosperity2020/>).

⁶ When funds are blended, funds from more than one separate funding source are combined within a program budget to pay for a set of services. Costs do not have to be allocated or tracked by individual funding source. When funds are braided, revenues are allocated and expenditures tracked by categorical funding source, necessitating cost allocation methods to ensure funding is not duplicated (Wallen and Hubbard 2013).

⁷ For example, the J. B. and M. K. Pritzker Family Foundation receives 2 percent interest on its \$4 million subordinate investment in the Massachusetts Juvenile Justice PFS Initiative.

⁸ A sinking fund is an account reserved for success payments. Sinking funds may receive annual allocations, or one lump sum allocation at the beginning of a project.

⁹ PFS projects in California, Colorado, Massachusetts, Ohio, and Utah are all operating under PFS-enabling legislation.

¹⁰ See *Toolkit Report #3: Outcomes Measurement and Pricing* (Rohacek and Isaacs 2016) for information on incorporating both social and economic benefits into outcomes pricing.

¹¹ *Relative to Pre-Kindergarten Education Using “Pay for Success” Financing*, S.B. 503-FN-A, N.H. Senate, 2016 Sess. <https://legiscan.com/NH/text/SB503/id/1300351>.

¹² Cash-on-cash returns is the ratio of annual before-tax cash flow to the total amount of cash invested.

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