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Donors Pool \$40 Million to Light a Fire Under Pay-for-Success Programs

By Alex Daniels



PHOTO BY ILENE PERLMAN

Last year the Jewish Vocational Service of Boston received pay-for-success funding from an impact-investing group that included Prudential.

A group of donors has created a \$40 million [pay-for-success](#) fund they hope will provide a nudge to a stalled form of social investing.

The Community Outcomes Fund was started by \$20 million in cash from former Microsoft chief executive Steve Ballmer and his wife, Connie, and \$10 million from Prudential Financial. The Kresge Foundation will provide up to \$10 million to shield investors from losses.

Kimberlee Cornett, managing director of Kresge's social-investment practice, is confident the fund will achieve its goal of raising \$75 million by attracting other investors who want to achieve social gains while scoring a financial return.

"You have a high-net-worth family, an experienced institutional investor with a social mission, and a philanthropy that's bringing some risk protection," she said. "That constellation of partners is the right thing to kick this off."

In a pay-for-success deal, private investors put money into efforts usually paid for by the government, like early-childhood education, [criminal justice](#), or work-force development. If all goes right, the investors support novel approaches to measure and address social problems. The goal is to meet previously negotiated outcomes, like a reduction in recidivism or increased employment, at a net savings to taxpayers. The process is intended to reduce the government's budgetary load, allowing it to give part of the savings to investors.

The fund plans to start making investments early next year. Investment decisions will be made by Maycomb Capital, which will manage the fund. Community Outcomes Fund isn't the only pay-for-success fund — the Reinvestment Fund, a community-development finance institution, maintains a separate \$10 million fund — but it bills itself as the largest.

Slow Progress

In 2010, after the introduction of the first social-impact bond, a type of pay-for-success financing mechanism in Britain, there was "a lot of oxygen" around the idea that a torrent of deals would follow, Cornett said.

But the rush largely failed to materialize.

In 2015, there were 30 projects at various stages of development, according to the Laura and John Arnold Foundation, which that year [launched](#) the Pay for Success Initiative at the Urban Institute to support the investment approach. A year later, 10 projects were underway and "dozens more" were in development, according to a tally by the Nonprofit Finance Fund. Two years later, a tally by the Community Outcomes Fund put the number of active deals at 18, according to the Community Outcomes Fund.

Because the definition of pay for success varies, there is no authoritative number of how many are currently in development. Kelly Walsh, who manages the Urban Institute effort, said 21 deals are currently in place.

Andy Rachlin, managing director for learning and investment at the Reinvestment Fund, views pay-for-success as a "high potential" niche market.

"There was a lot of chatter that far exceeded the deal flow," he said.

Early Stumbles

The novelty, complexity, and risk of the deals have stunted their growth, experts said.

A signature deal financed by Bloomberg Philanthropies and Goldman Sachs to reduce recidivism rates at Rikers Island failed to meet its targets, and investors were unable to chalk up any gains. In another deal, education experts questioned whether the correct measurements were used to track the progress of an early-education project in Utah and raised concerns that the success rate was inflated.

Miljana Vujosevic, vice president of Prudential's impact-investments group, believes risk comes with the territory. But even if projects don't work as planned, each investment will be an opportunity to collect data and learn lessons that can be applied in Prudential's other social investments, she said.

To bring more deals to fruition, a single fund that doesn't have to start from scratch on every negotiation will help solve the "brain damage" organizations get when they try to move forward on a deal-by-deal basis.

"There's a benefit to having one fund that can be the go-to source of capital for these projects," she said.

Cornett agreed, saying pay-for-success deals suffer from a bottleneck created by an overlap of government agencies and disagreements among groups of investors, each with different expectations of investment returns, requirements for reporting and underwriting, and opinions on the best method to generate social benefits.

"We believe that we'll simplify the structure for municipalities because there aren't so many people at the table," she said.

Obama Efforts

The federal government may also play a role in putting more pay-for-success deals in play, but there may be a delay as an [Obama-era program](#) winds down and replacement funds are deployed.

The federal government encouraged the growth of pay-for-success financing by making more than \$30 million in feasibility grants to nonprofits and researchers through the Social Innovation Fund. Congress this year zeroed out the fund, which had been created three months into Obama's presidency and was housed in the Corporation for National and Community Service.

But the well hasn't run dry. Lawmakers included the Social Impact Partnerships to Pay for Results Act, which created a \$100 million pay-for-success fund, in a broad budget deal that President Trump signed in February.

Money from the 10-year fund, which can be used to pay for feasibility studies and evaluation of investments and to pay investors a return, won't be available until next year.

Many investors and municipal leaders are eager to see if results from existing projects show promise and to determine what kind of interest the new federal fund generates, said the Urban Institute's Walsh.

"Everyone is sort of holding their breath," she said. "There's still a lot of potential for this model. It's too early to say we've learned all the lessons we can."