**THE PAY FOR SUCCESS GRANT PROGRAM**

AB 1837 appropriated $5,000,000 in local assistance from the Recidivism Reduction Fund to establish the Social Innovation Financing Program, now known as the Pay for Success (PFS) Grant Program.

PFS performance contracts—also known as “Social Impact Bonds”[[1]](#footnote-1) provide an innovative strategy to finance proven programs through public-private partnerships. PFS contracts are rigorous, binding agreements based on a straightforward proposition: taxpayers will pay only for services that achieve results and save money in the long-run. The strategy enables the state to fund programs and services that improve economic opportunity, health, and safety that it otherwise might not be able to afford in the short-term. Moreover, PFS directs funding toward programs that have a strong evidence base and track record of effectiveness.

AB 1837 authorized the BSCC to invoke pay for success financing to address persistent criminal justice challenges across the state. Pursuant to AB 1837, “it is the intent of the Legislature that as part of the package to reduce recidivism in California, the concept of ‘pay for success’ or social innovation financing should be included to take advantage of available philanthropic and private investment.” The broad purpose of the PFS Grant Program is to reduce recidivism using evidence-based approaches that may address such issues as homelessness, substance abuse, and unemployment.

Under the most common PFS model, the government contracts with an independent intermediary entity, or directly with a service provider, to provide social services. The government pays this contract-holder entirely—or almost entirely—based upon achievement of mutually-agreed upon performance targets. These performance targets are directly linked to taxpayer savings and are measured by comparing the outcomes of individuals referred to the service provider to the outcomes of a comparison group that is not offered the services.

The service provider obtains multi-year operating funds by raising capital from private, commercial, and/or philanthropic sources. If the contract-holder is an intermediary, it uses these operating funds to subcontract with one or more service providers to deliver the interventions necessary to meet the performance targets. If the services achieve the minimum outcome target(s) negotiated, the government repays the investors (often out of the savings it achieves from the preventative program). If the contract-holder fails to achieve the minimum target(s) negotiated, the government does not pay, ensuring that taxpayer funds are not spent on programs that are ineffective. Payments typically rise for performance that exceeds the minimum target, up to an agreed-upon maximum payment level. Independent monitoring and evaluation of outcomes is critical in PFS contracts, as government payment is predicated on the achievement of outcomes. Rigorous evaluation systems, which determine whether pre-established targets have been reached, can deepen California’s understanding of which programs work, and findings can be used to improve services throughout the state. This learning enables the state to spend taxpayer funds more effectively and scale up evidence-based, innovative programs that have been proven to work in California.

While there are many different structures that satisfy the principles of a pay for success project, the common characteristics include:

* Rigorous measurement of desired goals and outcomes, validated by an outside party;
* Performance-based payments made by the government, only if outcomes are met; and
* Private-sector and/or philanthropic financing.

AB 1837 provided approximately $4,750,000 for local grant awards in amounts of not less than $500,000 and not more than $2,000,000 for three local pay for success projects selected through a competitive-bid process.

A minimum of 100 percent match of the PFS Grant Project funding was required. Other county, federal, private, or philanthropic funds were allowable to meet the match requirement. Resources required for the match obligation could be cash or in-kind contributions or a combination of both.

Up to 10 percent of the grant funds awarded may be used by the counties for administrative expenses. The remaining 90 percent must be set aside by the county to repay investors upon the achievement of specific outcomes based upon defined performance targets. Any unused state moneys shall revert to the General Fund.

County Boards of Supervisors (BOS) were the eligible applicants applying for the PFS Grant Project. Funding awarded to the grantees is to be used to enter a pay for success contract with investor(s) to include the following:

* A requirement that the repayment to investors be conditioned on the achievement of specific outcomes based upon defined performance targets.
* An objective process by which an independent evaluator, selected by the county, will determine whether the performance targets have been achieved. This process shall include defined performance metrics and a monitoring plan.
* A calculation of the amount and timing of repayments to the investor(s) that would be earned during each year of the contract if performance targets are achieved as determined by the independent evaluator.
* A determination by the county that the contract will result in significant performance improvements, such as a reduction in rearrests or an increase in the number of jail days avoided, and budgetary savings if the performance targets are achieved.

Below is a table of the counties that were awarded funding.

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| --- | --- | --- | --- |
| Rank | County | Amount Requested | Amount Awarded |
| 1 | Los Angeles | 2,000,000 | $2,000,000 |
| 2 | Ventura | 1,500,000 | $1,500,000 |
| 3 | Alameda | 2,000,000 | $1,250,000 |
|  |  | ***TOTAL*** | ***4,750,000*** |

1. The term “Social Impact Bond,” which was coined in the United Kingdom, is a misnomer. The private-sector financing arrangement is not a typical debt instrument and these transactions do not require the government to issue debt. To avoid these misperceptions, these programs are often called “Pay for Success” performance contracts. [↑](#footnote-ref-1)