EXECUTIVE CHAMBERS

NEIL ABERCROMBIE
GOVERNOR

HONOLULU

December 2, 2013

The Honorable Donna Mercado Kim, President
and Members of the Senate
Twenty-Seventh State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

The Honorable Joseph M. Souki, Speaker
and Members of the House of Representatives
Twenty-Seventh State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear President Mercado Kim, Speaker Souki, and Members of the Legislature:

For your information and consideration, I am transmitting a copy of the report on the feasibility of using social impact bonds to fund early learning programs required by House Concurrent Resolution No. 119, 2013 Regular Session, prepared by the Department of Budget and Finance. In accordance with Section 93-16, Hawaii Revised Statutes, I am also informing you that the report may be viewed electronically at: http://budget.hawaii.gov/budget/reports-to-the-legislature/financial-administration-division/

Sincerely,

/s/
NEIL ABERCROMBIE
Governor, State of Hawaii

Enclosure

REPORT TO THE TWENTY-SEVENTH LEGISLATURE
2014 REGULAR SESSION

STUDY ON THE FEASIBILITY OF USING SOCIAL IMPACT BONDS TO FUND EARLY LEARNING PROGRAMS

Prepared by the
Department of Budget and Finance

In response to
House Concurrent Resolution No. 119
Twenty-Seventh Legislature
2013 Regular Session

December 2013

STUDY ON THE FEASIBILITY OF USING SOCIAL IMPACT BONDS TO FUND EARLY LEARNING PROGRAMS

I. INTRODUCTION

House Concurrent Resolution No. 119 (HCR 119), adopted by the 2013 Legislature, requested that the Department of Budget and Finance (B&F) conduct a study on the feasibility of using social impact bonds to fund early learning programs and services in the State. HCR 119 also requested that B&F consult with the Executive Office on Early Learning (EOEL), Department of Human Services (DHS) and Department of Education (DOE) in considering certain factors and the feasibility of establishing a pilot project.

In order to explore the feasibility of using social impact bonds to fund early education programs in Hawaii, this report responds to the following basic questions:

- What is a social impact bond?
- How does a social impact bond work?
- What is the history of social impact bonds?
- When does a social impact bond make sense?
- What are the benefits of social impact bonds?
- What are the drawbacks of social impact bonds?
- Would social impact bonds work for early education programs in Hawaii?

Conclusions are then drawn from the responses to these questions. In the drafting of this report, B&F consulted with EOEL, DHS and DOE as well as with investors and early education service providers.

II. WHAT IS A SOCIAL IMPACT BOND?

A social impact bond (SIB) is a new approach to financing preventive social services. A SIB is an agreement between government and an external entity, called an intermediary, to implement an intervention initiative to achieve certain social outcomes that will result in public sector savings. The intermediary raises capital from investors to pay for the upfront costs of the intervention services. The intermediary also contracts with service providers to deliver these services. Government repays the investors with a return only if certain agreed-upon outcomes are achieved. If the targeted outcomes are not met, then government does not pay out anything.

Contrary to its name, a SIB is not a traditional bond in which an investor loans money to a bond issuer for a defined time period at an agreed interest rate. Rather, it is a multi-stakeholder partnership between government, investors, intermediaries and service providers in which investors are paid contingent upon specified social performance outcomes.

SIBs are intended to scale proven preventive interventions while shifting the financial risk away from government. Because investors are only paid if defined outcomes are achieved, SIBs represent a new and different way to fund social programs in that successful results are rewarded rather than just well-intentioned activity. Because of this pay-for-performance approach, SIBs are also referred to as "pay for success" contracts or bonds. They are also referred to as "social innovation financing."

III. HOW DOES A SOCIAL IMPACT BOND WORK?

There are normally four primary parties to a SIB:

- **Government** including federal, state or local agencies that define the social outcomes desired and guarantee payment if target outcomes are met.
- **Private investors** who provide the upfront money to pay for the social services**.** This pool of investors may include commercial or philanthropic investors.
- **Intermediaries** who bring together the parties and broker the deal among government, investors and service providers. Intermediaries identify evidence-based interventions and qualified service providers, raise capital from investors, and work with service providers and evaluation advisors to ensure outcomes are achieved. Intermediaries may include private organizations already established for the purpose of providing intermediary services, such as Social Finance, MDRC or Third Sector Capital Partners, or a private or quasi-governmental organization created by government to manage the SIB.
- **Service Providers** who deliver the intervention services aimed at achieving the defined social outcomes.

Other involved parties include:

- **Targeted beneficiary population** who are the direct recipients of the social services (e.g., ex-prisoners or chronically homeless).
- **Evaluation advisors** who monitor and refine the social services, make midcourse corrections and provide oversight and support to ensure performance.
- **Independent assessors** who act as arms-length auditors to ascertain the extent to which target outcomes are met.

The main steps in establishing and implementing a SIB are normally as follows. It should be noted that because SIBs are only starting, there is some variation in their forms and processes.

<u>Step 1</u>: Government determines whether to pursue a SIB, including identifying and selecting an intervention, conducting data analysis (to determine potential benefits/savings and tracking capabilities), selecting a target population, ensuring there is adequate provider capacity, developing an evaluation methodology, conducting financial analyses (e.g., cost-benefit analysis, investor payment modeling, cash flow projections, etc.), and ascertaining investor interest.

<u>Step 2</u>: Government authorizes SIB and appropriates funds or otherwise commits to future funding for repayment of SIBs.

Step 3: Government procures the services of an intermediary and negotiates a contract. The contract specifies the target population to be served, intervention services, defined outcomes, means of measuring results, timeframe and financial aspects (amount of financing, interest rates, schedule and timing of payments, etc.).

Step 4: Intermediary raises capital from commercial and/or philanthropic investors.

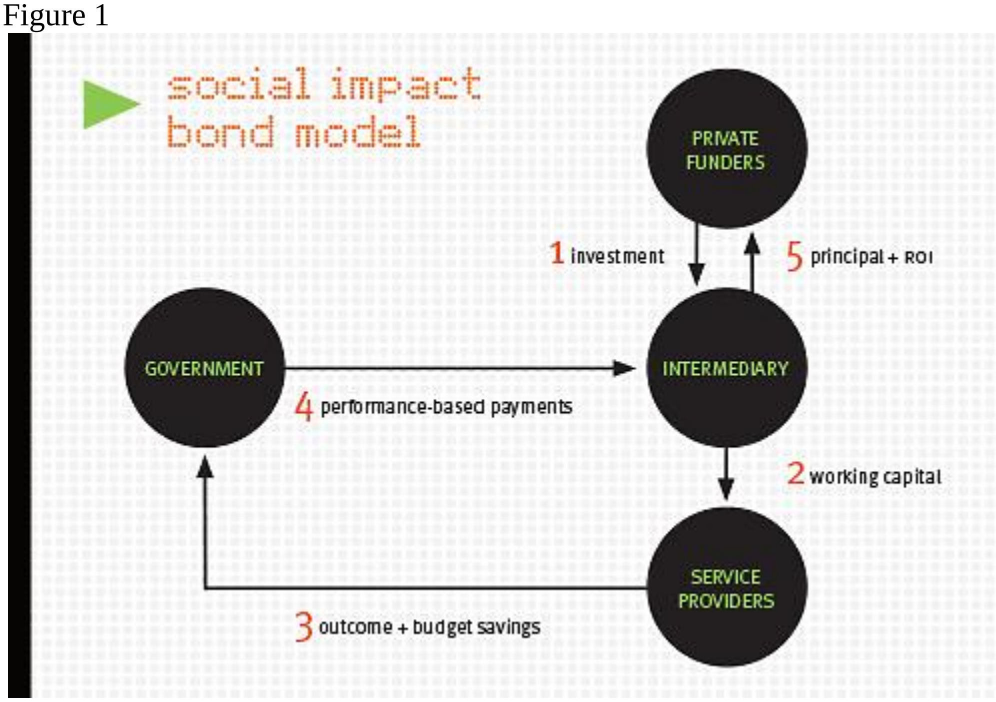
Step 5: Intermediary implements intervention program usually through service providers. Evaluation advisors, hired by the intermediary, conduct ongoing monitoring of the program to boost quality and performance of the intervention services.

Step 6: Independent assessors, hired by the intermediary, determine whether program outcomes are achieved.

Step 7: If outcomes are achieved, government pays intermediary who in turn pays investors. If outcomes are not achieved, then no payment is made. Returns to the investors may vary according to level of outcome achievement.

Figure 1 below illustrates the SIB model.

Figure 1



From *Market Values*, by Nadis, S., Harvard Kennedy School Magazine, Winter 2013.

To provide an example, the first SIB was executed in 2010 when the United Kingdom's Ministry of Justice contracted with intermediary Social Finance UK to provide services to 3,000 prisoners at Petersborough prison over six years. Social Finance raised £5 million from private investors to finance the program and contracted with a nonprofit to deliver the intervention services. The

British government calculated how much it is willing to pay for the outcome by looking at the savings likely to accrue over time as a result of the re-offending, including prison, court and police expenses.

If this initiative reduces re-offending by 7.5% or more relative to a group of similar prisoners discharged from other prisons not receiving the intervention, investors will receive from the British government a share of the long term savings. If the SIB delivers a drop in re-offending beyond the threshold, investors will receive an increasing return the greater the success at achieving the social outcome, up to a maximum of 13% per year over an eight year period.[1] The first determination of program outcomes and investor payments will be made in 2014.

IV. WHAT IS THE HISTORY OF SOCIAL IMPACT BONDS?

SIBs are a relatively new concept. The first SIB was launched by Social Finance UK in September 2010. Since then, the federal government, some states and cities as well as other countries have begun exploring SIBs. New York City established the first SIB in the United States for a program to reduce recidivism among young men jailed at Rikers Island. Figure 2 below lists current SIBs that have either started or been announced but not started.

The Nonprofit Finance Fund's Pay for Success Learning Hub recently created a Pay for Success U.S. Activity Map (http://payforsuccess.org/learn-out-loud/activity-map) that provides a general snapshot of PFS progress across the states, including those in the exploration or design stages (which have not been included in Figure 2).

Figure 2

Government	Description	Timeframe	Intermediary	Investors
Ongoing Projects				
UK Ministry of Justice	£5 m. to reduce recidivism among inmates at Petersborough Prison	Started in 2010 w/6-year timeframe[2]	Social Finance, Ltd. (UK)	17 investors including Rockefeller Foundation
New York City	$9.6 m. to reduce recidivism among 16- to 18-year olds who are jailed at Rikers Island	9/2012 to 8/2016	MDRC	Goldman Sachs[3]
Projects Announced but Not Started				
Utah State; Granite & Park City School Districts	$7 m. for early education program to reduce need for special education services in Salt Lake City	Has not started	United Way of Utah	Goldman Sachs & J.B. Pritzker
Massachusetts	$25 m. to reduce recidivism rates and increase employment outcomes for over 900 at-risk youth over 3 years.	Has not started	New Profit Inc and Third Sector Capital Partners	n/a

[1] Social Finance UK website.
[2] Determination of interim results and first payment will not be available until 2014.
[3] The New York City's SIB is backed by a $7.2 million guarantee by Mayor Bloomberg's personal foundation.

Government	Description	Timeframe	Intermediary	Investors
Massachusetts	Project to house 400 chronically homeless over 3 years.	Has not started	n/a	n/a
Federal Department of Justice	DOJ made two pay-for-success awards in Cuyahoga County, Ohio ($750k) and Lowell, Massachusetts for prisoner re-entry projects.	(Awards announced 10/1/2012)	n/a	n/a
Federal Department of Labor	DOL has made available $20 m. for pay-for-success projects that help unemployed find work.	n/a	n/a	n/a

The federal government's promotion of pay for success (PFS) began with President Obama's fiscal year 2012 budget which proposed $100 million to fund pilot programs in five federal agencies.[4] The President's fiscal year 2014 budget proposed the creation of a new $300 million PFS Incentive Fund that would support PFS initiatives at the state and city levels.[5] An additional $185 million was requested to support nine new PFS pilots in four agencies. Although these requests have not been authorized, the Administration has proceeded to launch pilots under existing budgetary authority (see federal projects in Figure 2).

The Utah SIB is the only example focusing on early education services. Further information on this project is provided below:[6]

- The Utah High Quality Preschool Program delivers a high impact and targeted curriculum to 3- and 4-year olds to reduce the need for special education and remedial services in kindergarten through 12th grade.
- Private capital from Goldman Sachs and J.B. Pritzker will finance an expansion of the Utah High Quality Preschool Program to up to five cohorts.
- The first $1 million investment will enable 450-600 children to attend preschool in the first year.
- Children will take a predictive evaluation test that serves as an indicator of their likely usage of special education and remedial services. Students that test below average will be tracked as they progress through 6th grade.
- SIB payments will be based on each year that tracked students do not use special education or remedial services.
- SIB payments will be made based on the actual avoided costs realized by the State of Utah, or 95% of $2,600 (annual special education cost per student) which equals $2,470 per child per year from kindergarten through 6th grade (with interest of 5%).

[4] Greenblatt, J. and Donovan, A. *The Promise of Pay for Success.* Community Development Investment Review. Federal Reserve Bank of San Francisco. Vol. 9, Issue 1, 2013, p. 20.
[5] Ibid., p. 19.
[6] Information taken from *Fact Sheet: The Utah High Quality Preschool Program* by Goldman Sachs, Pritzker Family Foundation and United Way.

- Thereafter, payments will equal 40% of the savings, or $1,040 per child per year of special education services avoided.

V. WHEN DOES A SOCIAL IMPACT BOND MAKE SENSE?

For a SIB to work, interventions should meet certain criteria as outlined next. An intervention should[7]:

- Focus on *prevention*. SIBs are designed to scale preventive services that address negative social outcomes and that save on future remedial costs.
- Have *observable and measurable outcomes*. SIBs are intended to scale interventions with measurable evidence of benefits and impact to society.
- Have a *significant magnitude of effect*. A SIB is justified only when the intervention shows that it reduces the negative outcomes considerably (e.g., 25% vs. 2% decrease in negative outcomes due to intervention compared to control group). Based on its research and experience in assisting governments with SIBs, Harvard Kennedy School's Social Impact Bond Technical Assistance Lab (SIB Lab) believes the most important criterion for deciding whether to do a SIB is its potential for a large impact.[8]
- Have a demonstrated record of *rigorous evaluations.* To attract investors, a SIB must show the intervention has proven its efficacy through credible evaluation strategies, e.g., randomized control trials or quasi-experimental designs. Investors will understandably be hesitant to invest in an untested intervention.
- Have a *long, proven track record* (at least five years). This past proven effectiveness is necessary to reduce the risk for the investor thereby making the SIB marketable. A SIB that focuses on proven interventions carries primarily execution risk, whereas a SIB that seeks to scale up promising but unproven interventions carries both execution risk and model/design risk related to the intervention.[9] With no evidence that the intervention could be successful, investors are less likely to finance a SIB.
- Meet the needs of a *sizable beneficiary population.* To justify the use of a SIB and to make the economics of the SIB structure work, the intervention should address the needs of a meaningful number of beneficiaries. Furthermore, to provide sufficient sample sizes for outcome assessment purposes, in general, at least 200 persons should be served per year.[10]

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[7] Adapted from *Rapid Suitability Questionnaires,* Nonprofit Finance Fund Pay for Success Learning Hub and *From Potential to Action: Bringing Social Impact Bonds to the US,* McKinsey & Company, May 2012.
[8] Azemati, H., et al. *Social Impact Bonds: Lessons Learned So Far.* Community Development Investment Review. Federal Reserve Bank of San Francisco. Vol. 9, Issue 1, 2013, p. 23.
[9] *From Potential to Action: Bringing Social Impact Bonds to the US.* McKinsey & Company. May 2012, p.19.
[10] *Social Impact Bonds, A Guide for State and Local Governments*. Harvard Kennedy School Social Impact Bond Technical Assistance Lab. June 2013, p.19.

- Be *scalable*. The intervention must be ready to be replicated and/or expanded, including having adequate and qualified service provider capacity to scale up the intervention.
- Have projected *benefits that outweigh the costs*. If the cost of the intervention exceeds the future projected savings in remedial costs, then a SIB does not make financial sense. Additionally, the costs of the investor's interest payments, intermediary services, evaluation advisor services and independent assessor services must also be factored into the cost-benefit analysis.
- *Deliver taxpayer benefits in less than 4-5 years*. SIBs are most effective if intervention effects and taxpayer benefits are realized within a reasonable timeframe. For investors, the longer the timeframe, the higher the risk. Shorter timeframes also benefit government due to political considerations.

Based on these criteria, the SIB intervention areas being pursued include criminal and juvenile justice (reducing prisoner recidivism), homelessness, early childhood education (reducing special education costs), healthcare preventive interventions, and workforce development.

VI. WHAT ARE THE POTENTIAL BENEFITS OF SOCIAL IMPACT BONDS?

Benefits to Government and Public:

- Encourages government to focus on outcomes and results versus activities. Government pays for successful outcomes only (versus paying upfront for the promise of success).
- Can improve program performance and effectiveness since all partners are focused on achieving success and additional oversight and support (via evaluation advisors) provided to the program.
- May help facilitate shift from funding remediation to prevention.
- Promotes innovation in social programs.
- Shifts risk of program success from government to private sector investors.
- Can potentially save public funds where successful preventative programs result in remedial cost savings that exceed SIB costs and payments.
- Brings together public and private sectors to tackle challenging social issues.
- Improves transparency and oversight of social services.

Benefits to Investors:

- Opportunity to earn a profit.
- Opportunity to help people and improve society.
- For philanthropic investors, provides rigorous performance assessments of the initiatives they are funding and offers way to scale these initiatives if proven successful.

"Impact investing" is a relatively new term that describes investments made with the intent to generate measurable social or environmental impact along with a financial return. Some believe SIBs are attracting interest because the community of "impact investors" is growing.[11]

Benefits to Service Providers:

- More funds available for preventative programs.
- Opportunity to scale up innovative methods.
- Opportunity to gain lessons from evidence-based programs.
- Encourages focus on measurable outcomes rather than activities or processes.

VII. WHAT ARE THE DRAWBACKS OF SOCIAL IMPACT BONDS?

SIBs are new and untested.

SIBs are a very new concept in the early experimental stage. Globally, there has not been enough experience with them to deem them a viable approach to funding social services. The first SIBs have not yet matured to the point of assessing outcome achievement. As such, most of what has been written about SIBs is speculative and based on theory and ideas rather than actual data.

While there is much excitement over this new form of financing, the success and effectiveness of SIBs will only be known after a meaningful number have been completed. If the initial SIB projects fail, the growth of SIBs could be derailed if investors become leery of the risks involved or if governments become embroiled in messy contract disputes. As Tracy Palandjian, Executive Director of Social Finance US says, "It's really too early to tell" whether SIBs remain on the periphery of government finance or become a key fiscal tool. "The track record of the early transactions will dictate the fate of the market."[12]

Furthermore, because SIBs are still in the infancy stage, best practices based on lessons learned have not yet been developed or gathered. In fact, SIBs are so new that there are variations in the structuring of SIBs as well as discussion on how to change SIBs to better meet the needs of the parties.

SIBs are not a source of new, additional funding.

SIBs do not raise new money for social programs since government ends up paying for the services when performance outcomes are met. As such, appropriating funding for a SIB in reality displaces funding for other programs. Theoretically, the remedial cost savings should be used to pay for the SIB and intervention costs, but most initiatives will not work out that neatly. For instance, savings in future federal special education costs cannot at this time be captured and used to pay for a SIB.[13] So, for such a SIB, State funds would be used to save on federal costs.

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[11] Op. cit., McKinsey & Company, p. 18.

[12] Holeywell, R. *Social Impact Bonds: Finding Funding for an Ounce of Prevention.* Governing. October 2012. http://www.governing.com/topics/finance/gov-social-impact-bonds-funding-for-prevention.html#

[13] Based on discussions with Department of Education staff.

Jon Pratt, Executive Director of the Minnesota Council of Nonprofits, points out the displacement of other funding by SIBs and notes, "There will be new sets of winners and losers, with SIB transactions advanced with persuasive arguments and novelty as a comparative advantage in the competition for resources."[14]

In fact, as SIB advocates point out, SIBs are less a financing method than they are a way to transform social services, spur innovation, shift the focus to results, and move away from funding remedial efforts to higher-impact, less costly preventive solutions. Some see SIBs as a way to impel the social services sector to become more innovative, outcome-focused and evidence-based.

Furthermore, SIBs are a more expensive way of operating a social program. Because of the additional costs of intermediaries, investors' return, evaluation advisors and independent assessors, the costs are higher than if government simply paid for the same services. As noted by McKinsey & Company in its report on bringing SIBs to the United States, "SIBs are an expensive way to finance the scaling up of preventive programs. A SIB's 'premium' is justified if conventional options aren't working, or if the SIB helps government, philanthropy, and other social sector actors align their priorities and play their roles more effectively and efficiently."[15]

There is a very small pool of potential SIB deals.
Having to meet all of the intervention criteria listed in Section V above inevitably whittles down the potential pool of SIB deals to a very narrow segment of the social services universe. Programs that do not have outcomes that can be readily observed and measured will not be appropriate for this type of financing. MDRC, the intermediary for the first U.S. SIB in New York City, notes that most social programs have little or no solid evidence behind them and concludes there is a very small pool of potential SIB deals.[16]

Even where programs have measurable outcomes, the benefits and savings reaped from the intervention must be significant enough to justify a SIB's costs. SIBs must offer enough savings from the intervention to cover the costs of the investor payments (with return on investment), intermediaries (including evaluation advisors and independent assessors) as well as possibly government staffing costs. This requirement narrows the possible targeted social services even further. The Harvard Kennedy School's SIB Lab has found that while initial discussions have focused on initiatives that could yield budgetary savings that fully cover program costs, most socially beneficial interventions are unable to meet this standard.[17]

SIBs are complicated and carry risk.
Instead of the direct relationship between government contracting with service providers, the SIB structure introduces additional parties and layers which complicates its establishment and implementation. Most importantly, government is contracting with an intermediary who

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[14] Pratt, J. *Flaws in the Social Impact Bond Craze.* Nonprofit Quarterly. June 18, 2013. http://www.nonprofitquarterly.org/policysocial-context/22149-flaws-in-the-social-impact-bond-craze.html
[15] Op. cit., McKinsey & Company, p.10.
[16] Butler, D., et al. *Using Social Impact Bonds to Spur Innovation, Knowledge Building, and Accountability.* Community Development Investment Review. Federal Reserve Bank of San Francisco. Vol. 9, Issue 1, 2013, p. 58.
[17] Op. cit., Azemati, p. 27.

orchestrates the financing and delivery of services as well as the program assessment. The intermediary will now stand between government and the work it might ultimately be on the hook to pay for. Whether government officials would -- or should -- readily surrender control and authority over the delivery of services, particularly in light of the high stakes involved, is a question to be seriously considered.

Daniel Stid of The Bridgespan Group is also skeptical that the procurement functions of federal, state and local agencies are ready, willing and able to use SIBs. He notes that officials are challenged implementing basic performance-based, two-party contracts and questions how they will fare with SIBs given the third parties, extended time horizons, independent impact evaluations, and all-or-nothing payments involved.[18]

The nature of the multi-party, cross sector SIB introduces complexities and risks, including intervention risk, execution risk, intermediary risk, appropriation risk and financial risk. SIBs are market-driven so all parties -- government, intermediary, investors and service providers -- must agree on the terms and each have their needs met.

VIII. WOULD SOCIAL IMPACT BONDS WORK FOR EARLY EDUCATION PROGRAMS IN HAWAII?

To make an initial inquiry into whether SIBs would work for early education programs in Hawaii the following questions were explored.

1. Is there the political will to commit a future amount of funding for a prevention or early intervention program that will save on future costs?

   As stated earlier, SIBs do not create new monies. Ultimately, if the social program's outcomes are achieved, government will pay for the services. There are advantages in that government does not pay if the outcomes are not achieved, but, obviously, the goal is to have success. Therefore, government, both executive and legislative branches, would need to be fully committed to funding the SIB and investing the time and resources necessary to establish and implement the SIB over an extended period of time.

   To reduce risk and attract investors, funds should be appropriated upfront or somehow guaranteed legislatively. If government does not commit to making the future payments when they come due, the risk of non-appropriation would likely kill the deal as investors perceive too much risk. The authorizing language enacted in Massachusetts gave full faith and credit authority to SIB payments and established a sinking fund by which the Legislature would steadily fund the payments over the life of the contract rather than requiring a future appropriation.[19]

   The Department of the Attorney General has been consulted informally, and it appears legislation or possibly a constitutional amendment may be required to appropriate funds

[18] Stid, D. *Pay for Success is Not a Panacea*. Community Development Investment Review. Federal Reserve Bank of San Francisco. Vol. 9, Issue 1, 2013, p. 14.
[19] Op. cit., Azemati, p. 30.

for the timeframe that a SIB would require. Pursuant to Article VII, Section 11 of the Hawaii State Constitution, "All appropriations for which the source is general obligation bond funds or general funds shall be for specified periods. No such appropriation shall be made for a period exceeding three years; provided that appropriations from the state educational facilities improvement special fund may be made for periods exceeding three years to allow for construction or acquisition of public school facilities."

Because SIB outcomes are not normally attained until 3-6+ years into the project, funds would need to be appropriated for such a period of time which would extend beyond the constitutional limits. Further research would need to be made to ascertain whether a fund could be established in which the Legislature appropriates SIB payout amounts into the fund for expenditure in future years.

Furthermore, the Department of the Attorney General noted that Article X, Section 1 of the Hawaii State Constitution, prohibits the use of public funds to benefit sectarian or nonsectarian private educational institutions and would, therefore, have to be amended if a SIB were to fund private early childhood educational institutions.

2. Is there an innovative early education intervention program that has proven it saves on future remedial costs and meets the other intervention criteria?

Jeffrey Liebman and Alina Sellman of the Harvard Kennedy School SIB Lab state, "These projects can work only if they produce a combination of social benefits and monetized savings such that both taxpayers and investors come out ahead. This level of success requires a highly effective program model and a highly effective provider organization. Both are hard to find. Indeed, early projects are turning out to contain more innovation and learning and less replication than we originally anticipated, because ***rigorously proven models of preventive services do not yet exist for most of the highest priority policy areas of state and local governments*** (emphasis added)."[20]

A brief presentation on HCR 119 and social impacts bonds was made to the Early Learning Advisory Board (ELAB)[21]. An informal survey was then sent to ELAB members to discover any potential early education interventions that might meet the SIB criteria as outlined in Section V. Out of its 19 members, one responded to the survey indicating the respondent was unaware of any early childhood intervention services that might meet the SIB criteria.

Informal discussions with local representatives in the field of early education indicate that the field may not yet be ready to pursue a SIB with a proven, evidenced-based early education intervention service.

[20] Op. cit., Harvard Kennedy School Social Impact Bond Technical Assistance Lab, p.18.

[21] Members of the Early Learning Advisory Board include representatives from the Departments of Education, Health and Human Services, University of Hawaii, Council of Mayors, Kamehameha Schools, Hawaii Association of Independent Schools, Hawaii Early Intervention Coordinating Council, philanthropic organizations, a parent representative, and service providers representing Head Start, center-based programs, family-child interaction learning programs, family child care programs, home-visiting programs and Hawaiian language medium early learning programs.

3. Are there service providers with the capacity to scale these interventions?

   The Harvard Kennedy School SIB Lab notes that provider capacity has been a significant challenge in establishing SIBs.[22] Provider capacity would need to be assessed once more is known about what SIB intervention is intended. As noted earlier, potential early education interventions have not been locally identified at this time. Once an intervention is determined, service providers will then have a better handle on the programmatic requirements such as staffing, including number and types of positions as well as qualifications and training.

4. Are there potential investors?

   To find out whether there is a market for a SIB, one would need to have at least the general parameters of a proposed SIB laid out so an assessment of its investment suitability could be made by investors. Investors, in general, want to see the intervention criteria listed in Section V met but each will have specific requirements or desires for SIBs that it will fund. Because this report is only a preliminary look into the SIB model and parameters of a proposed SIB are not available, potential investors were not approached.

5. Do the executive departments have the capacity and resources to develop and implement a SIB?

   Government must devote significant staff time in overseeing the development and implementation of a SIB, including issuing requests for information or proposals, procuring the services of an intermediary, examining data sets and systems, conducting the cost-benefit analysis, developing financial cash flow projections, etc.

   Further, staff overseeing a SIB would require particular technical expertise and knowledge in areas such as performance assessment and evaluation design, data collection and analysis, cost-benefit analysis and incentive contracting.

   For implementation of a SIB, Harvard Kennedy School SIB Lab estimates that at least 1.0 FTE would be needed to conduct monitoring and oversight, project management and evaluation support.[23]

   Given these considerations, additional positions would be likely be required to develop and implement a SIB.

IX. CONCLUSIONS

Investing in early childhood education is one of Governor Abercrombie's top priorities. The Governor's goal is to ensure that *all* of Hawaii's children are ready for school. Current efforts are

[22] Op. cit., Azemati, p. 29.
[23] Op. cit., Harvard Kennedy School Social Impact Bond Technical Assistance Lab, p. 28.

focused on the 4-year olds who would have accessed junior kindergarten programs but now cannot due to the elimination of junior kindergarten. This population includes approximately 3,500 children in school year 2014-15 and 4,600 in 2015-16. With this vision in mind, the Administration is wary of shifting significant time, resources and attention to establishing a SIB for a relatively small segment when the emphasis should be on providing early education opportunities to a broad and diverse population.

Furthermore, while there is much excitement about SIBs from various sectors of society, including government, philanthropy and investment banking, the reality is that SIBs are new and have no proven track record. The government agencies that are currently pursuing SIBs are pioneers as there are no templates or best practices to follow. Because SIBs are in an infancy stage and have many complexities, it may be prudent to wait at least a few years to see whether SIBs grow into a viable financing tool.

SIBs represent a new approach to social services that places its emphasis on identifying innovative ideas, testing their effectiveness, and scaling up the interventions that prove successful. The SIB concept is highly attractive since it is based on accountability, paying for social services that have quantifiable success.

These concepts are worthy of further pursuit. While Hawaii may not yet have the components needed to initiate a SIB in place, efforts can be started to nurture and encourage early education programs that experiment with innovative intervention methods and apply rigorous evidence-based measurements that will assist government, philanthropy and the public understand and quantify the program results and outcomes. As noted by various sources, the philanthropic community normally funds such pilot projects. Once an innovation has a proven track record, then a SIB can more seriously be pursued.

Lastly, it should be noted that this study provides only a preliminary review of the potential use of SIBs for early education programs in Hawaii. If the Legislature desires to look further into SIBs for early education services, more in-depth research and feasibility study would need to be conducted into the specific intervention to be pursued, potential service providers and the financial analysis of costs and projected savings.

X. RESOURCES

Center for American Progress:
http://www.americanprogress.org/series/social-impact-bonds/view/
The Center for American Progress is an independent nonpartisan educational institute dedicated to improving the lives of Americans through progressive ideas and action. The Center helps advance progressive ideas through a range of projects in key issue areas; one such project called "Doing What Works" includes articles and other educational materials on social impact bonds.

Coalition for Evidence-Based Policy: http://coalition4evidence.org/
The Coalition for Evidence-Based Policy is a nonprofit, nonpartisan organization that seeks to increase government effectiveness through the use of rigorous evidence about what works. Its specific goals are to incorporate two main reforms into government social programs: 1)

Increased funding for rigorous evaluations to grow the number of research-proven interventions and 2) **S**trong incentives and assistance for program grantees to adopt research-proven interventions, and put them into widespread use.

Federal Reserve Bank of San Francisco:
http://www.frbsf.org/community-development/publications/community-development-investment-review/2013/april/pay-for-success-financing/
The Federal Reserve Bank of San Francisco dedicated an entire volume of its Community Development Investment Review to pay for success financing (Volume 9, Issue 1, April 2013).

Harvard Kennedy School Social Impact Bond Technical Assistance Lab (SIB Lab):
http://hks-siblab.org/
The Harvard Kennedy School SIB Lab conducts research on how governments can foster social innovation and improve the results they obtain with their social spending. An important part of its research model involves providing technical assistance to state and local governments implementing pay-for-success contracts using social impact bonds.

McKinsey & Company: http://mckinseyonsociety.com/social-impact-bonds/
McKinsey & Company is a global management consulting firm which conducted a 12-month research and analysis into the opportunity for social impact bonds in the U.S.

MDRC: http://www.mdrc.org/
Created in 1974 by the Ford Foundation and a group of federal agencies, MDRC is a nonprofit, nonpartisan education and social policy research organization dedicated to learning what works to improve programs and policies that affect the poor. MDRC acts as an intermediary for SIBs.

Nonprofit Finance Fund Pay for Success Learning Hub:
http://payforsuccess.org/provider-toolkit
Nonprofit Finance Fund is a nonprofit Community Development Financial Institution that helps organizations connect money to mission effectively, and supports innovations such as growth capital campaigns, cross-sector economic recovery initiatives and impact investing. Through a grant from the Rockefeller Foundation, Nonprofit Finance Fund is providing resources (including the Pay for Success Learning Hub) to help service providers, governments, investors, and other stakeholders work towards making Social Impact Bonds, Pay for Success Projects and closely related innovative social financing approaches feasible in the United States on a systemic scale.

ReadyNation: http://www.readynation.org/PFS
ReadyNation's mission is to help state and business and philanthropic leaders build strong coalitions to support smart early childhood spending – spending that strengthens families and future workforce competiveness. ReadyNation is leading an active effort to develop the research, operational and legal frameworks needed to set up successful early childhood pay for success arrangements.

Social Finance, Inc.: http://www.socialfinanceus.org/
Social Finance, Inc. is a nonprofit that develops and manages innovative financial instruments that connect the social sector to the capital markets and generates both social benefit and financial return. Social Finance acts as an intermediary for SIBs.

Third Sector Capital Financing: http://www.thirdsectorcap.org/
Third Sector Capital Financing is a nonprofit that collaborates with government, funders, and providers to create pay for success and social innovation finance solutions. Third Sector is the intermediary for the Massachusetts pay for success project and acts as advisor to states or counties on social impact bonds.