

MNN Conference 2014



Navigating in an Outcomes Based World: Considerations for Participating in Pay for Success

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NFF as Trusted Advisor – 30+ Years Linking Money to Mission



Access to Capital

Loans and Lines of Credit
New Market Tax Credits
PRI Services
Pooled Financing Programs
Growth Capital Services

Strategic Financial Analysis, Management & Planning Services

Financial Diagnostics, Program Economic and
Scenario Modeling, Capitalization Planning
Business Model Analysis, Modeling &
Repositioning
Strategic Collaboration Planning
Facility and Reserve Planning

Impact Investing

Field Development
Capital Aggregation
Philanthropic Advisory Work
Provider Readiness Trainings
Complete “Stacked” Capital
Structured Finance

Thought Leadership & Partnership

Pay-for-Success and Social Impact Bonds
www.payforsuccess.org
Studies of the Nonprofit Economy
Advocacy on Funder Policies and Practices
Publishing, Expert Commentary, Keynotes,
Workshops & Panels

NFF: Supporting Investment Readiness & Field Building for Outcomes Based Funding



Act as an independent, honest broker to the PFS field

- Support various PFS approaches and stakeholders as they explore new “outcomes-based” financing models
- Build initiatives for accelerated learning and application of PFS
- Accelerate providers’ capacity to thrive in outcomes-based environment
- Increase impact of philanthropic investments to support this adaptation

Establish a centralized and interactive education platform for PFS information and dialogue

- The PFS Learning Hub: www.payforsuccess.org

A Frayed Safety Net: Sixth Year of Increasing Demand for Services



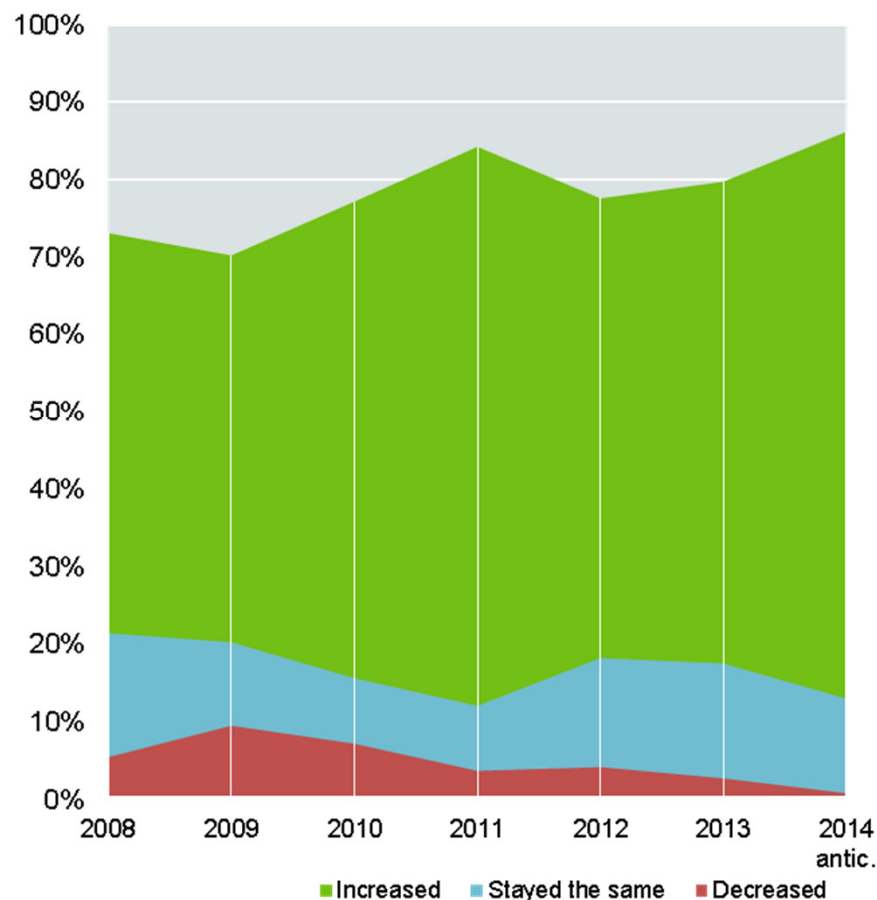
Over 5,000 leaders responded to NFF's 6th State of the Sector Survey.

- 31% Human Service
- 11% Community Development

The economic recovery is leaving behind many nonprofits and communities in need:

- **80% of respondents reported an increase in demand for services**, the 6th straight year of increased demand
- **56% were unable to meet demand in 2013**—the highest reported in the survey's history
- **86% expect demand to climb again in 2014**, and 58% expect demand to go unmet

In comparison to previous year, respondents reported demand for services....



55% of Nonprofits Subsist with Three Months or Less Cash on Hand



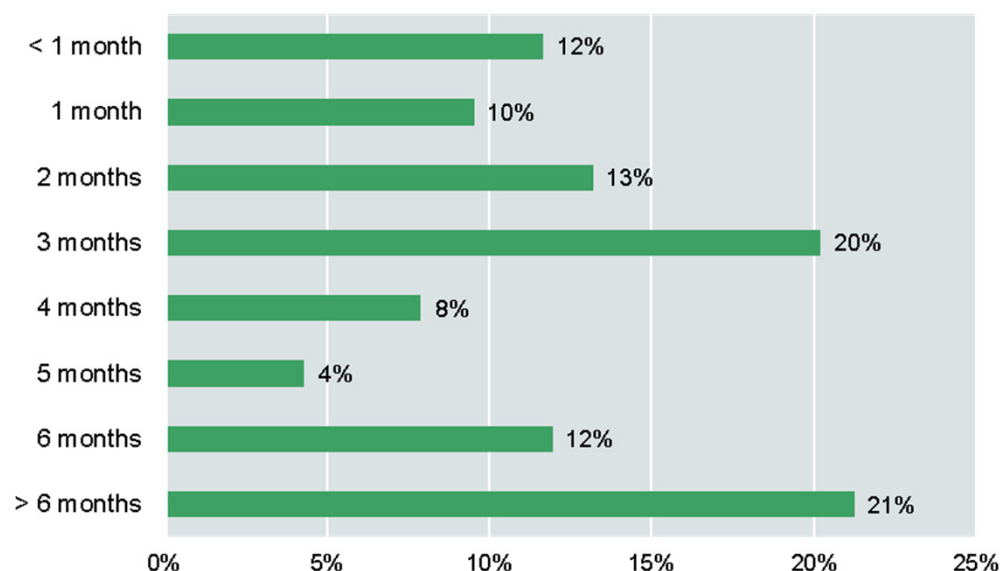
Financial results in 2013 were similar to past years:

- 28% had a deficit
- 31% broke even
- 40% had a surplus

Government funding, critical to many NPOs, has declined for nearly half

- 65% reported some gov't funding in 2014
Down from 76% in 2013
- Almost 50% of these reported a 5-year decline in gov't funding

How many months of cash are in reserves?



The less cash on hand, the greater the risk when revenue is late or unreliable.

Achieving long-term financial sustainability was the #1 challenge identified by 41% of survey respondents

The Funding Environment is Changing



Government

Status quo of...

- Cost Reimbursement
- Annual Contracts

Emerging practices....

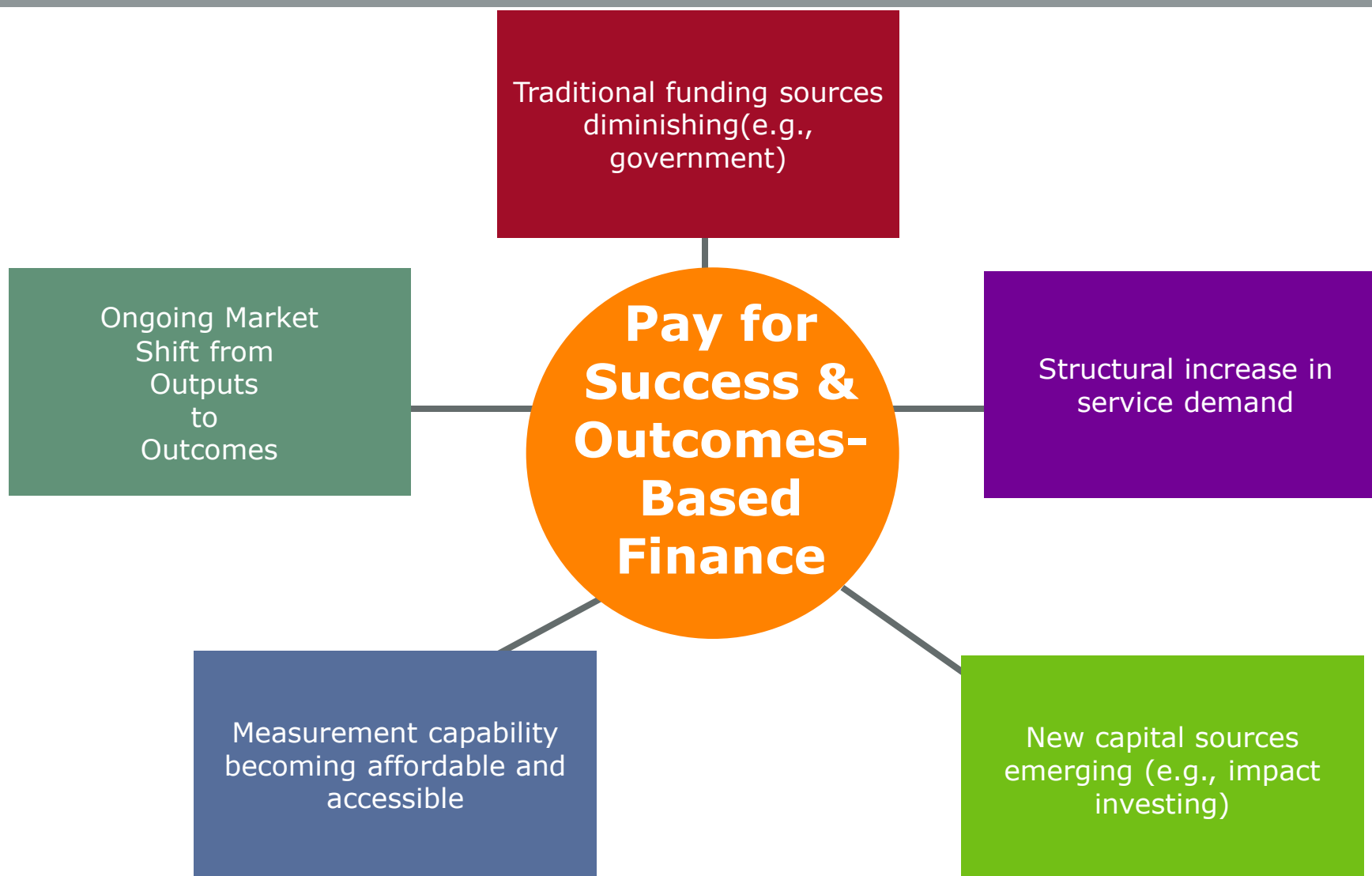
- Investing in "What Works"
- More Pay for Performance & increasing Pay for Success efforts

Philanthropy

- No expectations on return of funds disbursed
- Old Money, High Net Worth Individuals and Institutions
- Motivated by altruism

- Impact Investing: Expectation of financial & social return
- New money, younger, living donors & family foundations
- Purchasing social outcomes

PFS/Outcomes-Based Finance: Hub in the Wheel of Systemic Change?



Pay for Success: A Model that Drives Towards Outcomes



A contract (not necessarily a bond) that:

- Connects performance outcomes to financial return
- Monetizes social impact/outcomes
- Realizes costs savings (typically for government)
- Leverages private capital

Innovative integration of evolving practices (i.e., pay for performance, outcomes measurement) in the social sector at an opportune time– ***aligns interests in achieving social outcomes***

Social Impact Bond is one of potentially many ways to *capture the embedded values and linkages of ***Pay for Success financing****

Outcomes Based Finance: The Opportunities & Challenges



Challenges

- Understanding true costs & capacity
- Measurement can be complex
- Evaluation and Metrics not yet “standardized”
- Evidence/Data is still nascent for certain programs/interventions

Opportunities

- New funding/revenue streams during a time of government retrenchment
- Scaling potential of effective programs
- Multi-year contracting/capital
- Transparency and efficient use of public and philanthropic dollars

Organizational Capacity to Succeed in an Outcomes Based Funding World



Outcomes Measurement: Where Are We Headed?



Evaluation systems are tightly integrated into operations and useful to staff

The organization regularly reviews outcome reports

Facilitates data-driven decisions for continuous improvement

Validate that programs 'work' through internal and/or external evaluations

Attracts outcomes driven investments

The 'Gold Standard' of Measurement Capabilities

Outcomes Measurement: Basic Definitions



Theory of Change

Shows the links between a defined 'target' population, an organization's activities, and the expected outcomes. (i.e., written cause-and-effect statements)

Inputs

The resources—money, time, staff, expertise, methods, and facilities—that an organization commits to a program

Outputs

The volume of a program's actions, such as, number of people served or activities carried out

Outcomes

Meaningful changes for those served by a program, generally defined as changes in knowledge, skills, attitudes, behavior, condition, or status

Indicators

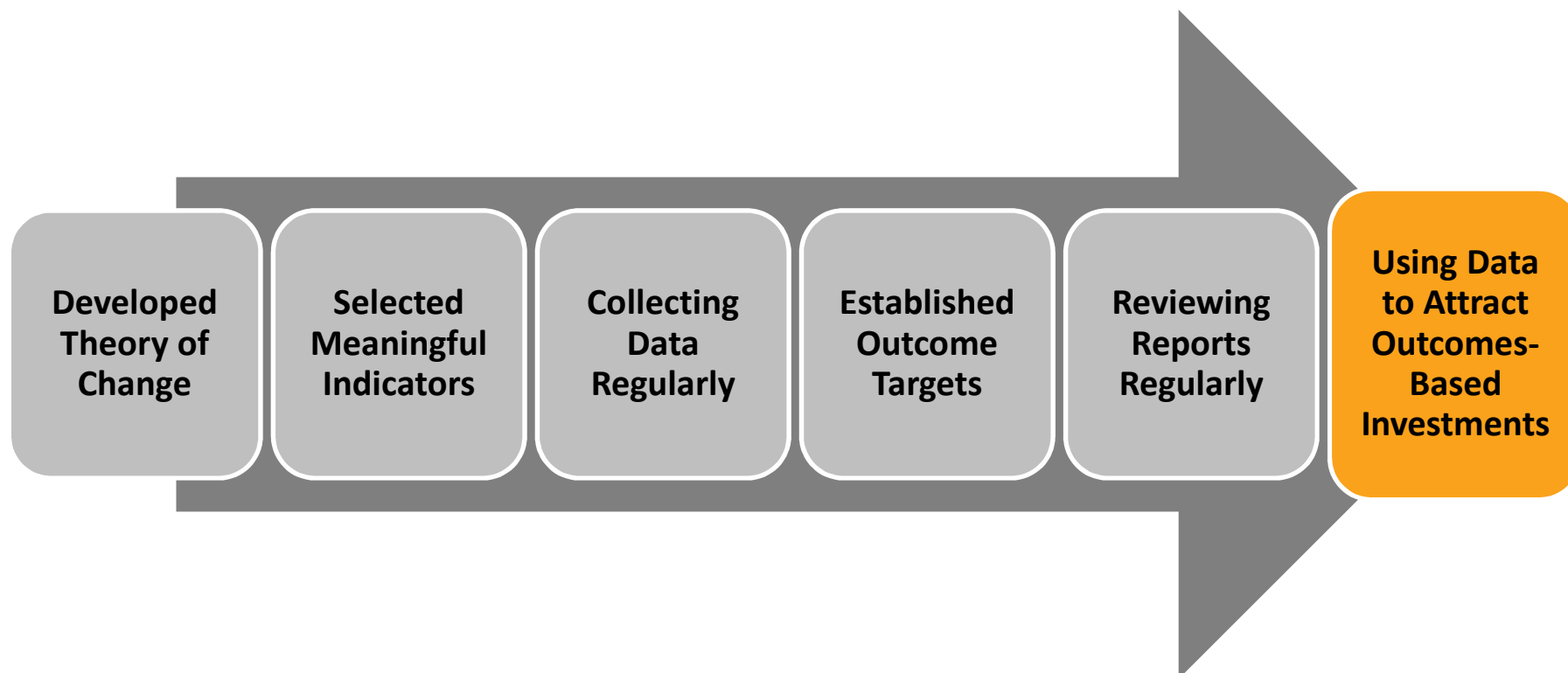
Specific, observable, and measurable characteristics, actions, or conditions that demonstrate whether a desired change has happened toward the intended outcome

Impact

The results that can be directly attributed to the outcomes of a given program factoring out other explanations

Adapted From: Leap of Reason, Mario Morino

Where is your organization on the Outcomes Measurement Continuum?



Action Steps: Outcomes Measurement



- **Assess** where your organization is on the “Outcomes Measurement Continuum”
- **Define specific benefits and costs** to building outcomes measurement capabilities for your organization
- **Identify steps** to build and improve your measurement systems and enabling **shift in culture**
- **Engage funders** in the process of building an outcomes measurement system, **build in evaluation** as a part of the cost of delivering services



- The Problem: Every year, over 4,000 high risk young adults age out of the juvenile justice system in MA, with over half reoffending 1-3x within the first three years of release, with high societal costs.
- Theory of Change: When young people are re-engaged through positive and intensive relationships they can gain competencies in life skills, education and employment that move them toward living out of harm's way and toward economic independence.
- Roca's Model:
 - Relentless outreach to build relationships with youth, includes knocking on doors, circling neighborhoods to find youth where they are
 - Building transformation relationships via case management by youth workers trained in cognitive behavior approaches
 - Stage based programming to both change behaviors and support sustaining of outcomes. Stages can include life skills, education, transitional employment and more advanced employment
 - Engagement with institutions (courts, school, probations, housing, health, benefits, etc.)

Financial Capital: Considerations for Adaptability



A Look Back:
Historical
Financial
Narrative

Understanding
The
Organizational
Changes
For Outcomes
Connected
Service
Delivery

**Building
Projections
that
Communicate
Change
Considerations
to
Stakeholders**

**Planning and
Budgeting for
Capacity and
Infrastructure
Needs and
Capital
Sources**

**Operating Plan
that
Integrates
Program
Outcome
Metrics and
Finances**

Management Understanding of
Financial Health and Resiliency

Are We Financially Adaptable?



Three high-level questions to assess if an organization is operating sustainably now:

1. Can you readily access the right financial data to make decisions? Do you have sufficient staff capacity and infrastructure?
2. Has the organization generated an unrestricted operating surplus in most of the past 4-5 years? (breakeven or better results)
3. Is the organization adequately capitalized to effectively run and maintain current programming?

Considering the Cost of Adaptation to Outcomes Measurement



An organization **changes** when it takes on an outcomes based financing transaction. This impacts expenses in two ways:

One Time, Upfront Expenses

- Consultants
- Feasibility Studies
- Technology Investments

Additional Annual Expenses

- New Staff
- Program Supplies
- Evaluation Costs
- Higher Audit Fees

Resources from outcomes based transactions **may not cover all** upfront expenses and recurring annual expenses in full.

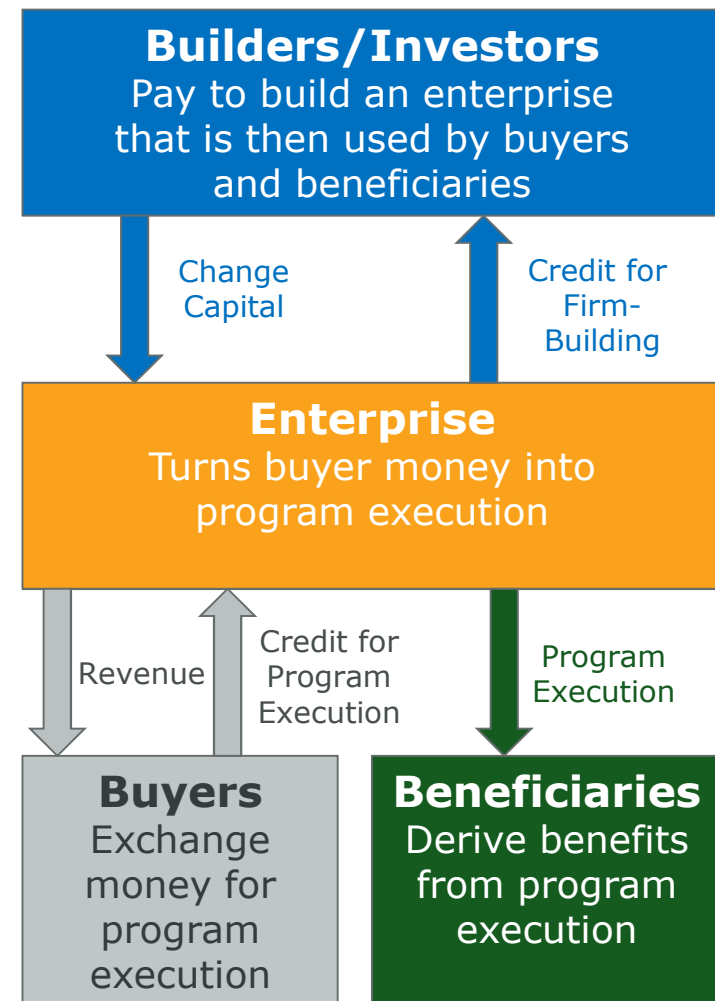
Change Capital (not revenue!) Promotes Adaptability & Durability



There are two kinds of funding:

- **Revenue from “Buyers” provides regular revenue**
 - Covers annual costs of programs & operations
 - Ticket sales, membership fees, program grants, contracts, etc.
- **“Change” capital from “Builders”**
 - Funds the enterprise: to transform what it does
 - Tends to be episodic in nature
 - Can enable growth and experimentation, or provides for risk reserve or deficit coverage

Nonprofits need both revenue and capital to thrive!



Human Capital: What is Required?



**Leadership
Team and
Culture with
Strong
Strategic &
Analytic
Mindset**

**Existing Staff
with
Performance
Management
Orientation
and Strong
Program
Skills**

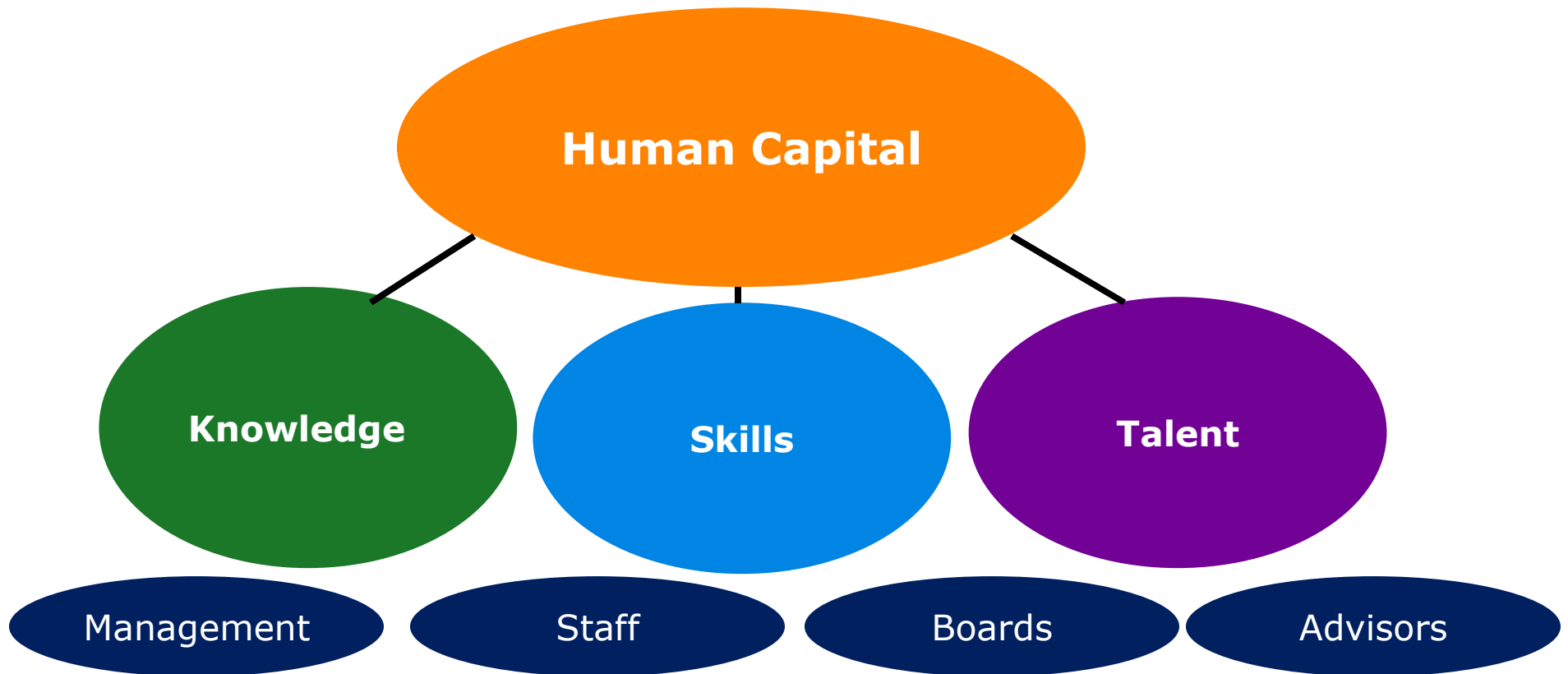
**Ability to
Retain, Hire
and Train for
Delivery &
Scaling**

**Identified
Team
Members for
Outcomes
Performance
Management,
Oversight &
Reporting**

**Administrative
Infrastructure
& Capacity
(IT, Legal and
HR) to Support
Outcomes
Delivery,
Tracking and
Reporting**

**Building, Developing and
Growing the Team and the
Culture**

Defining Human Capital



Social Capital: What is required?



**Connection
with
community
(target
population)**

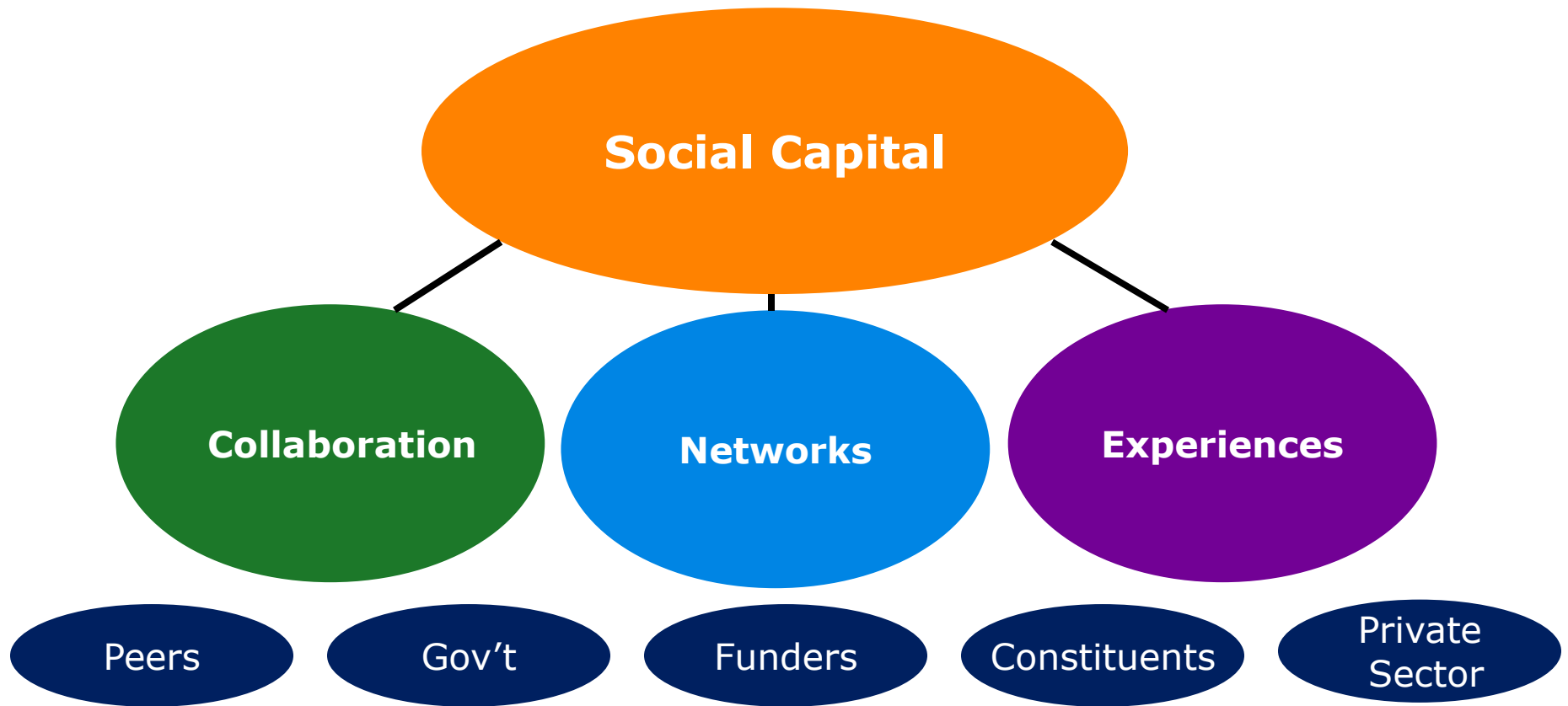
**Collaborative
muscle in
coordinating
multiple
partners**

**Willingness to
share
experiences
more broadly,
despite
potential
reputational
risk**

**Commitment
to
partnership in
times of
ambiguity
and change**

Harnessing collective power

Defining Social Capital:



Pay for Success: U.S. Market Evolution



To Date

- New York City – Aug. 2012- launched first SIB in US- \$9.6M to reduce youth recidivism
- Salt Lake City- June 2013- \$7M Early Education SIB for up to 5 cohorts of 3,500 children
- NY State – Dec 2013- \$13.5M to improve employment for 2,000 formerly incarcerated
- Massachusetts – Jan. 2014- \$18M to reduce recidivism among young men over 7 yrs
- Chicago- Oct. 2014- \$16.9M SIB to scale pre-K to up to 2,620 children over 4 years

Today

- Over 30 State, County and Municipal Governments Assessing Feasibility and Developing PFS Projects
 - *Interventions under consideration in DC, OH, CA, SC, IL, CO, MI, NY, UT, AZ, TX, and more*
- PFS at the Federal Government Level
 - Department of Justice - Second Chances Act to reduce recidivism
 - Department of Labor -\$20 million used in MA and NYS deals
 - SIF \$12M PFS Program- Oct 2014
 - Introduction of Federal Legislation with bi-partisan support: HR 4885 (SIB Act) & S 2692 (Pay for Performance Act)

Potential Framework for Considering PFS Projects



Stage 1: Exploration	Stage 2: Pre-Structuring	Stage 3: Transaction Structuring	Stage 4: Shovel Ready
<ul style="list-style-type: none"> ▪ Conversation among local stakeholders is occurring ▪ Education efforts have been undertaken/ are under way ▪ Initial ideas for suitable PFS projects are being discussed, considered, prioritized ▪ Government officials have expressed interest in PFS 	<ul style="list-style-type: none"> ▪ Informed consideration or due diligence of effective interventions/ programs that could be right for PFS in a community is underway ▪ Evidence to support the efficacy of such high-impact programs is being collected and evaluated by stakeholders ▪ Governments are undertaking (or engaging third parties to undertake) feasibility assessments and/or cost benefit analyses that look at the relative merits of scaling or implementing programs in a community ▪ Such feasibility assessments or cost benefit analyses determine the potential cost savings generated by projects under consideration 	<ul style="list-style-type: none"> ▪ Governments (or the back-end payors in a non-governmental transaction) have reviewed the due diligence completed for a potential project and committed to moving forward with structuring a PFS transaction ▪ A third party is engaged to structure a transaction, refine the program design and consider the delivery implications of a scaled project ▪ A procurement process (or direct engagement) of involved parties (providers, evaluators and intermediaries) takes place ▪ Potential investors are engaged 	<ul style="list-style-type: none"> ▪ Most, if not all, stakeholders (providers, evaluators, intermediaries, government agencies) have committed to the project ▪ The transaction has been substantially structured; Exact program design elements may need to be finalized ▪ Investors, investor terms or specific project design elements may remain outstanding/ need to be negotiated ▪ Contracts need to be negotiated

Supporting the Present & Building for the Future: Adaptability to the 'New Normal'



What can we do to both improve the current reality and build toward a better future?

Nonprofits

- Know the full costs of your services
- Describe those costs to funders effectively
- Measure outcomes and identify new revenue streams that could open up
- Collaborate where possible
- Say “no”: make tough choices
- Embrace change and emerge stronger

Funders

- Learn the full cost of services your grantees provide
- Commit to funding full costs and long-term sustainability
- Help pay for investments in measurement and for results
- Do not financially penalize collaborators
- Balance support to current needs with future sustainability

Additional Resources & NFF Pay For Success Learning Hub



NFF Pay For Success Learning Hub - A platform for education, best practices sharing and information dissemination on the potential benefits and challenges of PFS Financing in the United States. www.payforsuccess.org

CNCS SIF Grant - CNCS awarded \$12M through its Social Innovation Fund (SIF) to 8 grantees to support PFS projects. NFF was awarded \$3.6M to support service providers, governments and their partners as they develop PFS agreements.

http://payforsuccess.org/sifpfs/press_release

Rapid Suitability Questionnaires - Developed by NFF and McKinsey & Company, RSQs enable those who are in the initial phases of considering PFS to quickly evaluate organizational suitability to pursue this model.

<http://payforsuccess.org/provider-toolkit/rapid-suitability-questionnaires>

Capabilities Due Diligence Tools. Developed by NFF and McKinsey & Company, these tools provide a detailed framework to assess core capabilities for participation in a PFS transaction. These tools are designed to support advanced discussions and lay the groundwork for collaboration across the multiple stakeholders involved in a transaction.

<http://payforsuccess.org/provider-toolkit/deep-assessment-capabilities-due-diligence-tools>

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