Impact Investment

A Financial Solution to Fund Cities: North America

*"This has a political appeal because it's both **socially progressive** and **fiscally conservative**. That's a real winner." (George Overholser, Founder of Third Sector Capital Partners)*

Impact investment, in the broad sense, is a "pay-for-success" approach to social spending. Impact investment schemes and projects outsource social issues to the private/non-governmental sector. The public sector **only pays if the measurable impact is positive**, meaning if the scheme's success is granted, therefore saving the government from additional expenses.

A: Social Impacts Bonds

The most widespread and recognized impact investment tool available to local governments is the social impact bonds (SIBs). There are currently **14 SIBs** developed in the United Kingdom, launched by the non-profit organization Social Finance U.K. In the United States, the model remains circumscribed to the NYC Riker's Island Project, two Social Innovation Financing programs in Massachusetts, and a Human Capital Performance Bond (HuCap) in Minnesota. Harvard's JFK School of Government has recently launched a Social Impact Bond Lab to which **28 local governments** applied, hoping to receive technical assistance to pilot SIBs in their communities.

What are the advantages?

One of social impact bonds' main advantages is to offer an innovative method of **financing social issues' prevention programs** for which states and local governments struggle to get financial support. As another incentive for local authorities, SIBs protect **taxpayers** from a potential tax increase that would be needed to fund these programs.

What are the main challenges?

SIBs' opponents consider the mechanism as yet **another form of government privatization**. The bonds may also involve high equity risk for investors in the development phase.

Who is involved with Social Impact Bonds in the United States ?

The main SIB investors are:

- Rockefeller Foundation
- Harvard University John F. Kennedy School of Government
- Social Finance U.S. (Boston)
- Non-Profit Finance Fund (New York)
- Clinton Global Initiative
- Bloomberg Philanthropies
- White House Office of Social Innovation and Civic Participation

The most active NGOS are:

- Twin Cities RISE!
- Third Sector Capital
- Partners, Massachusetts Housing
- Shelter Alliance, Roca Inc.
- MDRC

Case Study: Riker's Island Project
Location: New York City, NY
Investor: Goldman Sachs
Backing: Bloomberg Philanthropies

In 2012, NYC was the first city in the United States to implement a Social Impact Bond scheme. It was used on a project to reduce recidivism amongst teen prisoners on Riker's Island. The program will take the form of cognitive behavioral therapy addressed to 16 to 18 year old young people, focusing on personal responsibility, education, training and counseling.

Goldman Sachs provided the $9.6 million loan while Bloomberg Philanthropies offered a $7 million backing. The money is funding the intervention of MDRC, an educational and social NGO created by the Ford Foundation in the 1970s. In parallel, the Vera Institute for Justice controls the evaluation of the project. MDRC is also working with the New York City Mayor's Office, the Department of Correction (DOC), the Osborne Association, and Friends of Island Academy to implement the project.

The objective of the MDRC's program is to cut the recidivism rate by 10%, thus decreasing public savings in public security expenditures, court proceedings and incarceration. If the goal is not met or falls short, MDRC will use the Bloomberg Philanthropies funds to repay Goldman: the local authorities won't be responsible to pay back, therefore the risk is not falling on the taxpayers.

This innovative partnership of public, private, and non-profit stakeholders is likely to see many replications if the Riker's Island project happens to be a success.

B: Development Impacts Bonds

Development impact bonds (DIBs) are gaining a lot of attention as a new business model enabled by a financing method.

The main difference between SIBs and DIBs is the reimbursement process to the investor. In the first case, local authorities are reimbursing the investors. In the latter case, the interest paid back to investors if the project succeeds falls on international donors, development agencies, or foundations participating in the DIB. Moreover, DIBs attempt to **increase the effectiveness** of traditional donor-funded development projects. Like SIBs, DIBs focus on the **quality of implementation** and the **successful results**. Although DIBs are currently debated at the national level, local authorities could one day use them as a platform for multi-sector development.

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