ID # (assigned by CSG): 12-E-08-MA

Please provide the following information, adding space as necessary:

State: Massachusetts
Assign Program Category: Government Operations and Technology
Program Name: Social Innovation Financing
Administering Agency: Executive Office for Administration & Finance
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1. How long has this program operated (month and year)? Note: the program must be between 9 months and 5 years old as of April 5, 2012 to be eligible for this year’s award.

Massachusetts started the process to pursue social innovation financing and pay-for-success contracts in December 2010. A procurement process is now underway, and we expect to sign contracts in the summer of 2012.

2. Describe the program:

Massachusetts faces increasing demand to deliver critical social services with a limited pool of resources. Traditional contracts compensate providers for inputs rather than outcomes, potentially wasting taxpayer dollars on unsuccessful initiatives and failing to help target populations. Achieving success in this context hinges on innovative methods and sustainable, preventable approaches. Governor Deval L. Patrick’s Social Innovation Financing (SIF) program seeks to unleash service delivery from the limitations of traditional contracts and short-sighted, one-year budgets.

The SIF procurement process will result in contracts targeting two challenges that have been resistant to services delivered through traditional contract models: 1) reducing recidivism rates for youth (18-24) aging out of the Department of Youth Services custody, and 2) stabilizing
housing and reducing Medicaid costs for chronically homeless adults. With a pay-for-success contract, government can channel money toward initiatives with proven results (and acceptable data to demonstrate success), shifting the risk of failure to the private sector and diverting taxpayer dollars from initiatives that don't work.

Both chronic homelessness and youth recidivism are of grave concern to the public for a number of reasons. The direct and deleterious impact these issues have on those directly affected is well-known and widely documented. In addition to the immediate impact, failure to adequately address underlying problems has resulted in downstream negative social and fiscal effects.

For example, previous initiatives in Massachusetts found that average Medicaid costs for chronically homeless individuals were $26,000 before they were housed and $8,500 after they were housed. Addressing the root cause (homelessness) of downstream effects (health problems) is the best and most cost effective way to address public challenges.

Pay-for-success contracts have their own unique challenges, such as:

- **Working capital**: providers usually lack the immediate resources to be able to deliver services throughout the contract period, at which point payment would become available depending on the degree of programmatic success.
- **Risk aversion**: many service providers cannot absorb the risk of failing to achieve performance targets.

There are many ways to structure contracts that offset risk and leverage capital. One way is for the providers to raise funds using a social impact bond (SIB), in which the government contracts with both intermediaries and service providers. One model for this approach would be for the intermediary to raise capital to fund the operating costs of service providers who bear the responsibility for achieving the desired outcomes. Alternative structures for the intermediary-provider relationship will also be considered in order to best leverage the strengths of providers and intermediaries.

Given this uncharted policy territory, Massachusetts is taking an open-ended approach to SIF procurement. Separate requests for responses were issued to providers and intermediaries as part of this process. This will allow for a contract structure that best leverages the strengths of the providers and intermediaries.

At a pre-determined time, an independent program auditor will evaluate the extent to which the contract was successful. The government only pays out the cost of the contracts that are deemed successful. If not, the contract comes at no cost to the state and investors are not repaid.

While the first attempt at realizing the value of SIF is currently being piloted in the United Kingdom, the potential for success can be illustrated when considering the following:

- **Traditional contracting** is often inefficient and ineffective because it tends to emphasize inputs rather than outcomes, thus allowing unsuccessful initiatives to persist for years.
  - One-year budget cycles make it difficult to finance long-term, preventative measures – particularly in social services.
  - Tight budgets make state governments wary of putting taxpayer dollars at risk for new initiatives.
- **Return on investment (ROI)** and risk management best practices are effective in all other sectors.
- Aligning the interests of investor-level organizations with direct service providers creates more joint value.
- Leveraging an array of stakeholders is a more efficient method for managing risk than concentrating it with individual service providers.
- Pay for quality and efficiency is a more effective value creator than paying for quantity.

Formal procurement request for responses were posted in January 2012, and submissions were accepted on March 9, 2012. Procurement management teams are in the process of reviewing these groundbreaking proposals. Massachusetts anticipates signing these first-of-their-kind contracts in the summer of 2012.

3. Did this program originate in your state? If YES, please indicate the innovator’s name, present address, telephone number, and e-mail address.

Massachusetts is the first state in the United States to take formal steps toward a comprehensive social innovation financing model. The first attempt is currently being piloted by the United Kingdom Justice Ministry, and the federal government plans to test the approach as well.

4. Are you aware of similar programs in other states? If YES, which ones and how does this program differ?

No. Massachusetts is the first state in the country to issue a competitive procurement to obtain services using this approach.

5. What limitations or obstacles might other states expect to encounter when attempting to adopt this program?

States looking to replicate this approach should make it a priority to develop a pipeline of ideas that fit into the preventative social service framework. Finding proven ideas may be a challenge, but some amount of established research along with a sensible explanation why the population is being under-served may be sufficient for further analysis.

States should also carefully consider how they will analyze and capture savings. Both program specific savings, including efficiencies that improve long-term capacity, as well as savings in other areas of government will need to be captured to make these programs work. Social benefits should also be carefully documented, but are likely too subjective to include in the ROI analysis that Massachusetts intends to approach for every project.