

Notes for Pay for Success Social Impact Finance: Salt Lake City Pre-K Project December 5, 2013

Presenters

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Notes

Four leaders in social impact finance will be discussing the Salt Lake City Pre-K Project, the country's (and possibly the world's?) first results-based financing of an early childhood intervention.

Janis Dubno will discuss the background research. Andrea Phillips will talk about Goldman Sachs' role and interest in the project. Jeff Schoenberg will talk about how J.B. Pritzker became involved. And Bill Crim will tell us about United Way of Salt Lake's role in the project.

Dubno: Early education research shows that high quality preschool can be successful in reducing the special education assignment for economically disadvantaged children, which provides a cost avoidance for state and federal governments. Voices for Utah Children partnered with United Way of Salt Lake, the Granite School District, and Goldman Sachs to quantify the cost avoidance.

We studied children who attended preschool in the 11 most poverty-impacted schools—free/reduced lunch was at least 80%. In 2005, the Granite School District had an early reading first grant to study what components of high quality preschool showed the most beneficial outcomes for children. 737 children over three years were assessed using the Peabody Picture Vocabulary Test. Children who scored at least two standard deviations below the mean were followed. In these neighborhoods, over 30% of children, 238 of them, scored that low (compared to 3% of the population in a normal distribution). But through fourth grade, only 11 of these 238 students were referred to special education. Note that this was economically-disadvantaged children only, not special education part B kids. We also followed academic achievement through fourth grade. All economically disadvantaged children in the district in fourth grade

were 58% proficient in language and math, but the preschoolers were at 78% and 76% respectively, compared to 78% and 78% for students statewide. So the achievement gap was closed.

We also quantified the reduction in SpEd assignment for the state, and just for those three cohorts it was \$1.8M. We decided a pay-for-success model would be more effective than a sustainable financing model, because it allows us to expand the program more rapidly. The cost ratio and the effect ratio are both such that this made sense, so we began working with Goldman Sachs and the United Way of Salt Lake to structure a potential social impact loan.

Phillips: Goldman Sachs has a team that focuses on double bottom line, or impact, investing—we invest the firm's and our clients' capital in a way that provides both a financial return and a social impact. It's been going on for about a dozen years. Traditionally we had focused on real estate, but we began looking at social impact bonds and investing in recidivism issues. Then we started talking to Bill and Janis in Utah and were quickly convinced this opportunity to finance early childhood education was incredibly compelling. We looked at it the way we look at any investment opportunity—social impact first, and then the opportunity for financial returns. There's an incredibly rich body of literature on the impact of early childhood education on special ed, long-term outcomes like high school graduation and lifetime earnings, even health outcomes. Then we took a look at the track record of the program in the Granite School District.

So the way this works is that Goldman Sachs and J.B. Pritzker provide loans to United Way of Salt Lake, which acts as an intermediary and uses that money to pay the day-to-day expenses of providing early education to three- and four-year-olds through the Granite School District, the Park City School District, and a few private providers. With the first year's financing, 600 kids have started preschool in Salt Lake. The payout for the investors is tied to cost avoidance—the kids who go through the early education program and don't need to use special education or remedial services in K-6 grades generate payments. Students are evaluated by a third-party evaluator, Dr. Mark Innocente, using the Peabody Picture Vocabulary Test and are tracked for SpEd usage. Each kid that doesn't use the services generates payments of 95% of what it would have cost to use the services, or about \$2400. Once the principal of the loans is repaid plus 5% interest, the payment then goes down to 40%, or about \$1,000.

Schoenberg: Initially, we expected the state of Utah to assume a leadership position in this transaction. When that didn't happen, J.B. Pritzker stepped up, looked at the project, and decided to assume a place in the transaction. It's an evidence-based intervention with rigorous quantitative analysis, and it works as a double-bottom-line

transaction, so J.B. Pritzker decided to put private capital into this project.

As a side note, we hope that this will not only help influence the growth and development of an alternative financing instrument, but also recalibrate how the public sector evaluates what defines success for a social interaction.

Also, we're very careful to describe this as cost-avoidance rather than savings, because we don't want to create a level of expectation in the public sector that this money can be spent elsewhere or used to reduce a budget deficit. It's a genuine avoidance of additional expenditures, spending proactively and addressing a pressing social problem.

What we, and J.B., would eventually like to see is that these alternative financing structures would develop and mature to the point that they are rated and traded like GE bonds.

Crim: Our United Way has changed its focus from being a fundraiser and fund distributor to being a facilitator of large-scale community partnerships focused on cradle-to-career social change. When Janis started telling us about the potential of a sustainable financing mechanism for the Granite School District, we wanted to do whatever it would take to make it succeed. In the Salt Lake valley, between 60 and 80% of kids are not ready for kindergarten. We have now enrolled every kid we could find in preschool, and this foundation of early learning will transform that community. Those kids have the same opportunity to succeed now that anybody else does.

To talk about being an intermediary, it's a learning experience every day—we're problem-solving, engaged in conversations with key stakeholders. And I think I speak for everybody when I say we feel a sense of responsibility to make this very successful. This kind of transaction has many components to it, including the ability to form partnerships and collaborate with multiple goals in mind. This requires trust building and facilitation. The intermediary role is really, in the language of collective impact, a backbone role.

Utah's legislature seems to be changing its conversation to one that acknowledges that in order for schools to succeed and for the state to have a strong economy, we need high quality preschool.

Phillips: Adding to that, by Goldman Sachs and J.B. Pritzker putting their resources behind this intervention, it has lent it credibility, in addition to all the research. I think that has helped facilitate the change in conversation Bill is talking about.

Q&A:

Jacqueline Sly (South Dakota State Legislature): What would South Dakota need to do as far as state policy in order to have social impact bonds for pre-K?

Schoenberg: From a legislative standpoint, there are a couple of variables to take into account:

Policy change, a statutory change that would formalize the state taking a financial role in a transaction. Every state is different in how it defines those relationships statutorily.

An appropriation would likely be necessary to further cement a true public-private partnership.

I'd like to add we believe it's very important for a third-party evaluator who referees the transaction to determine the cost-avoidance. It takes pressure off the public sector and makes investors more comfortable.

Phillips: The three things that have to be there for results-based financing to work are:

An intervention and an organization that can provide it that has a demonstrated track record of impact.

An investor who can provide upfront financing (like Goldman Sachs)

Someone to sit on the other side of the results-based financing contract and be the source of repayment for the loan. That could be local, city, or state government. The particulars of what we need from that government depend on the jurisdiction and local legal environment.

For example, in Massachusetts, the legislature passed legislation authorizing the Secretary for Administration and Finance to enter into results-based financing projects for up to \$50 million. They also addressed the issue of appropriation (which is a big concern for investors concerned in changing politicians and laws) by putting the full faith and credit of Massachusetts behind the structure of the contract.

Final Comments:

Dubno: Social impact, or results-based, financing help shift funds from remediation to prevention. We also feel that we think this structure drives quality because of the rigor with which Goldman and J.B. Pritzker analyzed the data and looked at the investment.

Dugger: Of course. We all care about the kids and they're our first priority. Of course, as we do this proof-of-concept, this could be a self-extinguishing activity as once governments understand how cost avoidance can be achieved they may choose to finance it themselves.

Another potential issue is that there could be a moral hazard here, that there is a risk assignment methods or standards for assigning students to special education could change, which we would need to watch very carefully...

Dubno: Andrea actually brought that up while we were planning. It's very important that special education assignment in K through 12 is blind to the financing mechanisms. Aside from all the normal regulations and oversight, the people doing the assignments may not even know if the kids participated in preschool, let alone how they were funded, so there's really no risk.

Dugger: We are reaching the end of our call. We will have a similar conference call in January focused on the South Carolina project that is developing a methodology for results-based financing of home visiting, prenatal and infant counseling, and support characterized with the Nurse-Family Partnership, Healthy Families, and other home visiting programs.