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California May Introduce Social Impact Bonds

Social impact bonds (“SIBs”), sometimes referred to as “pay-for-success” financing, may arrive in California. A bill introduced in the legislature, [SB9](#), would establish the Office of Social Innovation and Entrepreneurship Development. The purpose of this governor’s office would be “to establish partnerships with government agencies, private investors, nonprofit organizations, and for-profit service providers to facilitate the use of social impact bonds to address social services needs.”

A “social impact bond” is an investment arrangement in which private funding sources finance a social program administered by a nonprofit organization or a for-profit service provider on behalf of a government agency. The government agency enters into a performance-based contract with the provider, pursuant to which the government only pays if the provider accomplishes specific social outcomes that the government wants achieved. Unlike conventional bonds, which generally involve an unconditional return of capital plus interest, payment on an SIB is contingent on the accomplishment of the specified social outcomes.

Performance-based contracts are typically used in areas where results can be measured quantitatively and producing the results can save the government money. For instance, creating additional housing for the homeless may be a measurable goal, and accomplishing this goal may reduce government expenditures on social services in the long run. The government then pays back investors from the anticipated savings. If the provider’s approach does not achieve the desired outcome, the government is not out any money. The risk instead is taken on by the SIB investors.

Great Britain pioneered the concept of SIBs a few years ago with financing for a program to reduce recidivism rates for prisoners at Peterborough prison. By helping parolees find housing and other support, the program aims to reduce the recidivism rate by 7.5 percent. The assessment period is not yet up, and investors are waiting to see if the program will succeed. More information about the Peterborough experiment and SIBs in general is available [here](#).

SIBs may be a good candidate for program-related investments (“PRIs”). A PRI very generally is an investment in which the primary purpose is to accomplish a charitable goal rather than to generate income. Private foundations and other charities may be willing to accept the risks involved with an SIB in order to facilitate new approaches to addressing pressing social concerns. You can find more information on PRIs [here](#).

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