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The Micro-Social Impact Bond

A Framework for 21st Century Social Innovation

Achieving mainstream social impact in the new global knowledge-based economy.

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Design and Finance of Social Impact Systems

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The Design and Finance of Social Impact Systems

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INTRODUCTION BY EAN GARRETT, J.D.

Chief Executive Officer, Infinite 8 Institute, L3C

Infinite 8 Institute's mission is to design and finance social impact systems in order to assist individuals, organizations, and communities adapt and thrive in the new global economy. We utilize design thinking principles in order to create high performing environmental and social systems that are thoughtful, rigorously researched, and blended with the experience of highly qualified and competent professionals.

The topic of the Social Impact Bond (SIB) is more important than ever before. As our global economy teeters on the brink of economic turmoil, with issues such as poverty, education inequality, unemployment, and immigration there is a call for new and innovative methods, such as the creative financing inherent in the SIB structure. There is an urgent need for intelligent and capable individuals, across many sectors, to collaborate in order to solve some of society's most dire problems.

It is essential that those seeking to create impact, actively engage and seek out collaborative opportunities, to work alongside the diverse populations actually living in the social and environmental conditions we seek to change. There must be a sense of humility among all involved in achieving social progress, and a deep understanding of the value that even the most deprived mind can offer towards altering the course of their own destiny.

During the fall of 2014, our organization served as an SIB intermediary, bringing together over 20 organizations, who collectively sought to create the World's First Social Impact Bond for Violence Prevention. Ultimately, the municipality involved lacked the political will to fund such an initiative. In our efforts to utilize the traditional Social Impact Bond structure, we ran into many obstacles and barriers toward the creation of an SIB, and such obstacles forced us to quickly innovate, adapt, and evolve our efforts into something else. While our efforts failed to produce a SIB, what we were left with was something surprisingly beautiful—the Micro-Social Impact Bond (Micro-SIB).

Over the last six months we have utilized the Lean Business Model, a model more widely known for its use in the start-up world, for the streamlining of the Micro-SIB. It was invigorating to utilize a proven private sector approach for creating social innovation. As we currently assist organizations around the country create social impact solutions, utilizing the Micro-SIB, it is our desire that others will learn from our experience.

Understanding that in the field of social impact we all seek a similar destination, bettering the world, we hope that this publication may prove an effective vehicle for helping get us there.

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The Design and Finance of Social Impact Systems

WHAT IS A SOCIAL IMPACT BOND?

Social Impact Bond's or (SIBs), which are debt or equity instruments – sometimes referred to as "pay-for-success," "social innovation financing" or "outcome-based financing arrangements" – through which third-party investors take on the financial risk associated with expanding social programs.[1] Often confused with traditional financial instruments such as Stocks or Municipal Bonds, SIBs more often consist of complex contractual arrangements that differ greatly among the various examples in existence. However, SIB's have more recently morphed into the realm of traditional bonds adding an additional level of complexity.

In a global society where government is increasingly facing fiscal restraints, SIB's have been sought after as a creative response for preventively addressing societal issues and achieving government cost-savings through the funding of proven interventions, strategies, and methodologies. To date, there are six SIB's currently in the implementation phase in the United States, while there are roughly 50 still in the design phase since the first SIB was announced by Goldman Sachs for recidivism in 2012.[2] This backlog has kept the social impact instrument from going mainstream, largely keeping the design, contract structure, and implementation strategies a mystery to interested stakeholders. From our experience the market has been asking for heightened transparency.

MACRO & MICRO SOCIAL IMPACT BONDS

Before discussing the difference between Macro-Social Impact Bonds (Macro-SIBs) and Micro-Social Impact Bonds (Micro-SIBs), we must first define them. Similar to Macroeconomics, which deals with the decisions of government and nation-states, Macro-SIBs similarly have a governmental element, where government is primarily involved in a substantial capacity. In contrast, Microeconomics address how people and business allocate resources and value products and services. In a similar vein, Micro-SIBs are created as private transactions that are initiated by people and non-governmental entities, where government plays a minimal role in their development.

However, much like Microeconomics and Macroeconomics could not exist without the other, Macro-SIBs and Micro-SIBs are also co-dependent, as the ultimate aim of any local innovation achieved, is to scale it so that the mainstream may enjoy such innovations. A prime example is the invention of the modern alternating current (AC) electrical supply system by Nicholas Tesla, which was privately funded, and eventually made it possible for electricity to be enjoyed by 82% of the world's population today, after wide-spread adoption by global government and nation-states.[3]

While the traditional or Macro-SIB structure varies among each transaction, there are

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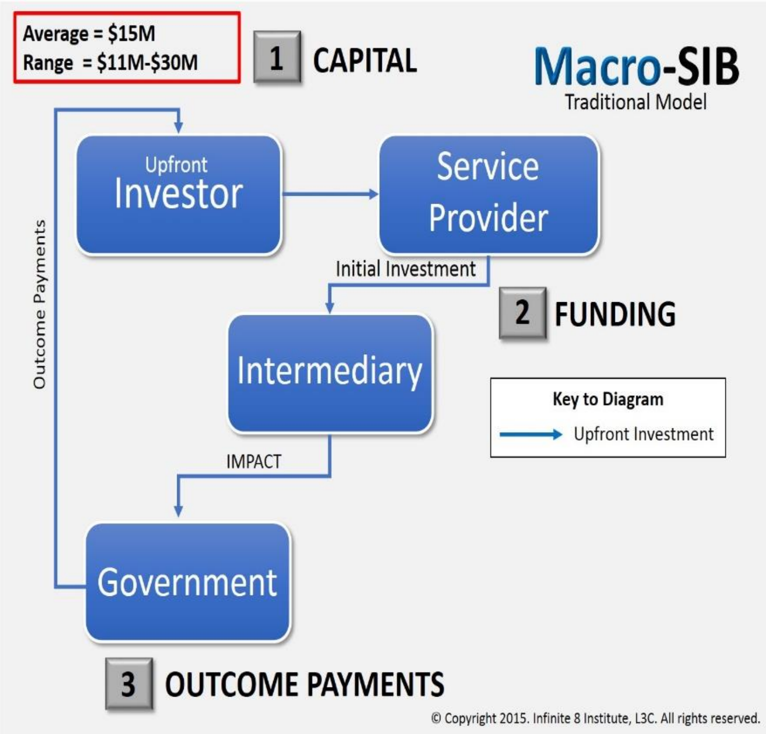
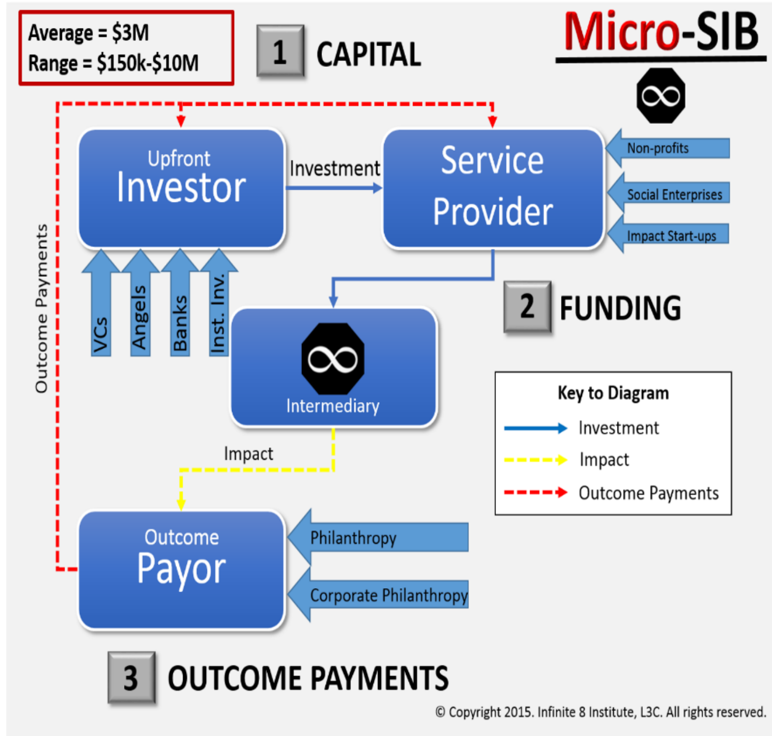
[1] The Center for American Progress describes SIBs as: an innovative financial arrangement between one or more government agencies and an external organization—sometimes called an "intermediary" – that can either be a nonprofit or for-profit entity. *See, e.g.,* Kristina Costa et al., *Frequently Asked Questions: Social Impact Bonds,* CTR. FOR AM. PROGRESS, 3 http//:www.americanprogress.org/wp-content/uploads/2012/12/FAQSocialImpactBonds-1.pdf (last visited on Aug. 7, 2015).

[2] Gustafson-Wright, Emily, Gardiner, Sophia, Putcha, Vidya. 2015. *The Potential and Limitations of Impact Bonds: Lessons from the First Five Years of Experience Worldwide.* Brookings Institute: 22, http://www.brookings.edu/research/reports/2015/07/social-impact-bonds-potential-limitations.

[3] "World Energy Outlook – Energy Access Database." *IEA.* IEA, 4 September 2015. Web. 7 September 2015.

MACRO & MICRO SOCIAL IMPACT BOND COMPARISON





- **Government-related Transaction**
  - Government Outcome Payor
  - Government Financial Administrator
- **Legislation and/or Executive Action Required**
- **Outcomes Payments Based on Benchmarks**
- **Cost-savings Vary**
- **Non-standard**
- **Scalable Proven Practices**
- **Capital Requirements of $11M+**

- **Private Transaction**
  - Philanthropic Outcome Payor
  - Private Financial Administrator
- **No Legislation or Executive Action Required**
- **Outcome Payments based on Per-capita Formula**
- **Integrated Government Cost-savings**
- **Standard**
- **Scalable Proven Practices & Scalable Innovation**
- **Capital Requirements of $150k-$10M**

certain similarities among them that distinguish them definitely from the Micro-Social Impact Bond (Micro-SIB).

The Macro-SIB is a public transaction, where government either pays investors for successful outcomes, or government serves as the financial administrator of funds, using the full faith of the government to add legitimacy to the transaction and mitigate investor risk. Furthermore, these public transactions also require some form of government action, either through multilateral means such as legislation, or through unilateral means such as executive action. Government intervention through the creation of legislation can be done at the municipal level through city ordinances, or legislation at the State and/or Federal Level. An example of a Macro-SIB being created by government intervention at the municipal level, is the Richmond SIB for Affordable Housing.[4]

[4] City Council Resolution No. 58-15. Richmond City Resolutions. Richmond Municipal Archives. http://ca-richmond.civicplus.com/ArchiveCenter/ViewFile/Item/6595.

Additionally, concerning the formation of Macro-SIBs, outcome payments are often based on the achievement of predetermined benchmarks, such as the Rikers Island Social Impact Bond for Juvenile Recidivism in New York.[5] These models also vary concerning the cost-savings to be achieved. Not all Macro-SIBs quantify created cost-savings to government or purport to do so. Also, the wide variety and non-standardization of Macro-SIBs leaves much room for creating innovation, however, it also leaves many stakeholders in the dark concerning a consistent understanding of what the functionality of the SIB structure is.

The Macro-SIB also utilizes proven practices that have promise of achieving similar outcomes in alternate social or environmental situations. Governments and stakeholders want proven practices as it is easier to pitch ideas to decision-makers utilizing methods that have already been implemented and achieved some level of success. Furthermore, as a result of the capital requirements of Macro-SIBs, which range from $11M-$30M, decision-makers want to ensure that if they are committing to a transaction that there is a high likelihood of success.

In contrast, the Micro-SIB is a private transaction, where private individuals and organizations raise capital, implement programming, and pay for outcomes that ultimately benefit government and save taxpayer expenditures over a specified period of time. The management and administration of funds is also facilitated by the private sector. Although, in spite of the private nature of the Micro-SIB, there must be partnerships and collaboration with government in order to scale successes born out of private initiatives. With such a model, government takes on no risk, but stands to reap political, economic, and public benefits.

As a result of the private nature of the Micro-SIB model, there is no legislation that must be created or executive action that must be initiated before Micro-SIB stakeholders may take actionable steps toward the implementation of desired social or environmental initiatives. Additionally, outcome payments are based on a per-capita formula, where investors receive a portion of their initial investment, plus interest, for every successful outcome that is achieved. This means that even if an educational initiative seeks to achieve a graduation rate of 80 out of 100 students, if the service provider only achieves a graduation rate of 79 students, investors will receive a return for those 79 students, mitigating overall investor risk.

Government cost-savings are an integral part of the Micro-SIB model. Cost-savings are calculated through the implementation of feasibility studies, which determine quantifiable metrics that fiscally matter. Therefore, although government and ultimately tax-payers are not committed to paying for successful outcomes, they are still benefitting from the implementation of such initiatives. Such an arrangement allows Micro-SIB stakeholders to gain tangible evidence of cost-savings and successful outcomes, which later provides decision-makers with the necessary leverage needed to gain public support for scaling up experimental pilot programming.

The Micro-SIB model also utilizes a standard contract formation, which allows stakeholders to gain a sense of their obligations, roles,

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[5] Porter, Edwards. "Wall St. Money Meets Social Policy at Rikers Island." *Wall Street Journal.* Web. 6 September 2015. http://www.nytimes.com/2015/07/29/business/economy/wall-st-money-meets-social-policy-at-rikers-island.html?_r=0.

commitments, and provides a base to build from. Nevertheless, while contract formation is standard, it is also flexible with the ability to provide customization according to the specific needs of the client and community stakeholders involved.

One similarity between the Micro-SIB and Macro-SIB, concern the utilization of proven practices during the implementation of social or environmental initiatives. However, there is a stark contrast beyond the use of proven methods. The Micro-SIB was created with innovation in mind, allowing for experimental initiatives that are smaller in scale, with less risk to investors, and less pressure on service providers' efforts toward failing forward in search of new discoveries that can ultimately benefit the public good.

Finally, the average capital requirements for the Micro-SIB are $3M USD. The amount of capital requirements range from $150k to $10M USD. An example of a qualified Micro-SIB, in terms of upfront capital requirements, can currently be observed in Portugal. The Calouste Gulbenkian Foundation recently funded an educational initiative involving 3 schools and 65 students, who will learn coding over the course of an academic year for $148,000 USD (€120K).[6]

MICRO-SIB KEY ROLES

In the traditional Macro-SIB model, there are a number of roles, which include: Upfront Investor, Service Provider, Intermediary, and Outcome Payors. With the Macro-SIB model, Upfront investors have generally been large banking institutions or philanthropy. Service providers are almost always non-profit organizations. Intermediaries have been relegated to a few organizations, such as Third Sector Capital or Social Finance. Finally, outcome payments are traditionally provided by government upon a showing of success.

Upfront Investors

In the Micro-SIB model, targeted upfront investors are small-midsize or family owned banking institutions, venture capital firms, angel investors, and institutional investors, such as insurance companies who can provide capital as well as risk-management for transactions. What separates the up-front investor from any other role is an expectation of breaking even, or making a below-market rate return on their initial investment. Investments take on the form of loans, provided to fund the initiative for the duration of the Micro-SIB, with an expectation of receiving their initial investment, plus interest. Interest rates vary according to the risk or benevolence of investors, and are negotiated each time a Micro-SIB is created.

Service Providers

Additionally, the Micro-SIB caters not only to non-profit service providers, such as an after-school or job training program, but it also incorporates newer hybrid models, which include social enterprises and impact start-ups. The newer hybrid models bring a rigorous private sector approach to the social impact sector, as well as providing the systematic sustainability of putting profit on par with achieving successful social and environmental outcomes. An example of a social enterprise or impact start-up is ICouch.me, which is an online healthcare app that pairs users with mental health therapists, who typically charge between $65 and $90 for personalized 50-minute mental health sessions.[7] Opening up service

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[6] "The First Social Impact Bond in Portugal." *Social Investment Lab.* Laboratório Investimento Social. 18 March 2015. Web. 7 September 2015. http://investimentosocial.pt/junior-code-academy-infographics/?lang=en.

[7] Desmarais, Christina. "17 Game-Changing Health Start-up." *Inc.* Inc., 27 March 2012. Web. 7

opportunities to a broader range of organizations, enhances the probability of innovation and matching need with qualified services.

Intermediaries

In traditional Macro-SIB models, intermediaries often take on many roles. These roles range from the facilitation and management of projects, to the raising of capital to fund an initiative. In the Micro-SIB model, the intermediary provides programmatic design services from idea inception, such as coalition-building, relationship management, fund-raising, as well as project management and advocacy.

Philanthropy

There is a significant role that private philanthropy has played in the social impact space. With Traditional Macro-SIBs, philanthropy has been the main force behind funding projects with an expectation of either breaking even or receiving a return below the market-rate. In the Micro-SIB model, private philanthropy is delegated to its more traditional role of grant-making without an expectation of a return, which goes towards funding successful outcomes. Per-capita outcome payments are determined by individual costs associated with serving a single beneficiary, plus interest. Therefore, if a program costs $5,000 to serve one beneficiary, and the agreed upon interest rate is 5%, then private philanthropic payments for a single successful outcome would consist of $5,250.

The Philanthropic organization has an incentive to pay for outcomes, because they are usually funding similar initiatives without any guarantee of success. In contrast, with the Micro-SIB model, philanthropy maximizes each donor dollar by only paying for what works. Additionally, as a result of upfront investors bearing the entire risk of failure, philanthropy pays investors back their initial investment for each successful outcome, plus a premium in the form of an agreed upon interest rate.

Corporate philanthropy also serves as a potential actor in the role of paying for successful outcomes. Many corporations often have a philanthropic arm whose role is designated as promoting the welfare of others. Corporations stand not only to benefit through the promotion of a company's brand or image through cause-related marketing, but also through the boost in employee morale, and in terms of positioning themselves well in the fierce corporate fight for top talent. Cisco Systems is doing just that, by integrating short-term social goals, with long-term economic strategies, through the creation of the Cisco Networking Academy. The academy not only focuses on benefitting the educational system at-large, but by providing high quality training opportunities they are producing future network administrators and gaining an edge over their competitors by scouting talent early.[8] The Micro-SIB model serves as a tangible opportunity for corporate philanthropy to put non-performing dollars to work.

Financial Administrators

A less discussed but equally important role is that of the financial administrator. In the Macro-SIB model, this role is usually delegated to government as the administrator of raised capital. This role has also been filled by private capital groups. In the Micro-model, the intermediary never handles funding, but rather

September. http://www.inc.com/ss/christina-desmarais/17-game-changing-health-tech-start-ups.html.

[8] Porter, Michael, Karemer, Mark. "The Competive Advantage of Corporate Philanthropy." *Harvard Business Review.* 1 December 2012. Web. 7 September 2015. https://hbr.org/2002/12/the-competitive-advantage-of-corporate-philanthropy.

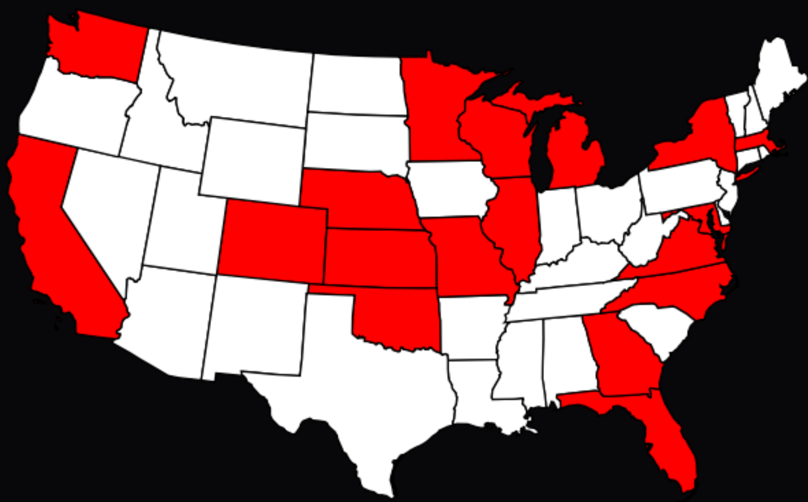
101 INTERVIEWS

The Micro-Social Impact Bond

Lean Process

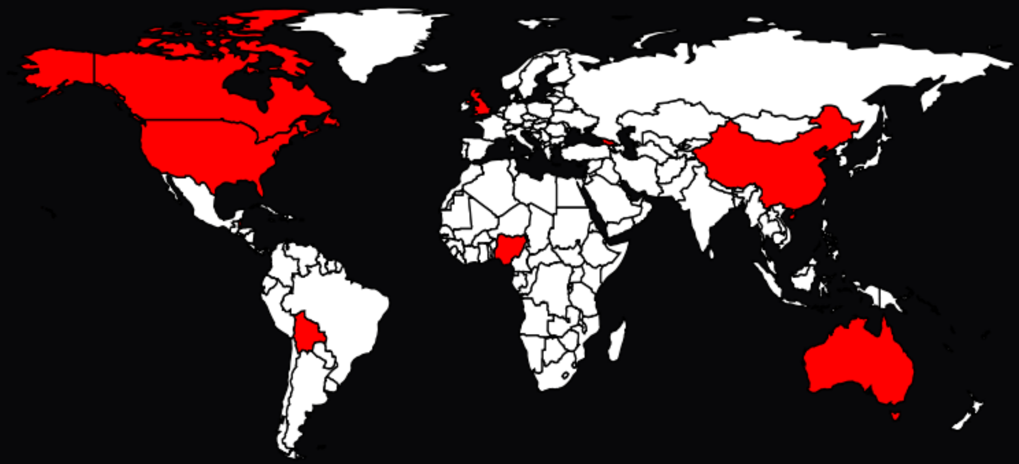
The Lean start-up process offers a scientific approach toward the creation and management of start-ups, providing continuous testing and adaptation to create capital efficient companies that leverage human creativity.

U.S. Interviews



Thought leaders were engaged across multiple sectors in a total of 17 U.S. States, including the District of Columbia.

Global Interviews



For vs. Against
Social Impact Financing

49.5% +

VS

50.5% –

Of those organizations who expressed a strong interest in Social Impact Financing, 52% expressed a desire for no government involvement, while 48% expressed a desire for government involvement to be optional.

utilize reputable third party administrators such as a Community Development Financial Institutions (CDFI) or capital fund. As both models evolve, it is foreseeable that other parties may step into this role.

LEAN FINDINGS: 101 INTERVIEWS

The Lean process has been utilized for some time in the start-up world, having given birth to success stories, such as Air BNB, the bed and breakfast phenomenon disrupting the hotel and motel industry. The Lean process is a thoughtful way to prove assumptions in the market, before actually spending time and resources only to find out preconceived notions were completely wrong. It is a streamlined process, where getting out into the real world, and talking to real people with real issues, who are currently in the market you seek to enter, puts those willing to put invest the time far ahead of the curve.

In the social sector, this concept is far from new, with such instruments as stakeholder surveys and similar techniques being heavily utilized to enhance impact among non-profit organizations. However, as a hybrid organization, or low-profit limited liability company and social enterprise, where impact is on par with profit, there is always a grey area where neither the for-profit or non-profit approach provides all the answers.

However, because most organizations rarely take out the time to wade across sectors in order to learn valuable information and the language of parallel sectors, the skill is rare among human capital of becoming savvy in the implementation of cross-sector solutions to address field specific problems.

Over the course of three months, stakeholders and global thought leaders were engaged on six different continents and in six different countries around the globe. With 90% of the interviews taking place in the United States, the main focus of the initiative was to gauge the pulse of the social impact sector throughout America, while also learning from SIB markets and non-market participants around the world.

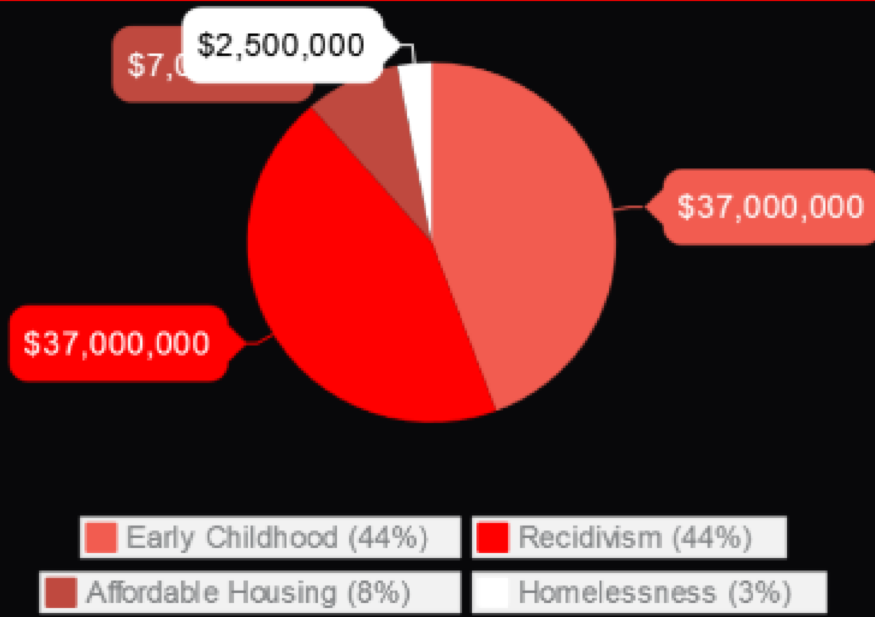
In a multisided market, one of the questions presented was which market segment is the most important? It is the old chicken or the egg conundrum. Should intermediaries cater towards philanthropy, investors, or service providers? Are philanthropy and investors the most important, providing much needed capital and resources, or is it the service provider on the ground, actually achieving outcomes and meeting or exceeding performance expectations who is most important? We discovered that every actor is important in order to create successful social and environmental outcomes. Both sides of the market must have a meeting of the minds for these transactions to work.

Some of the common concerns of service providers did not concern funding, but the nature of the funding and philanthropic expectations attached to the funding that do not place the service provider on equal footing. Service providers also discussed a desire for more flexibility in funding opportunities to spend funds in areas where they feel it is needed most. Returns that investors stated as palpable on average ranged from 5%-8%. On the lower end of the financial spectrum, some investors even went as low as providing 0% interest loans, with the expectation of timely repayment.

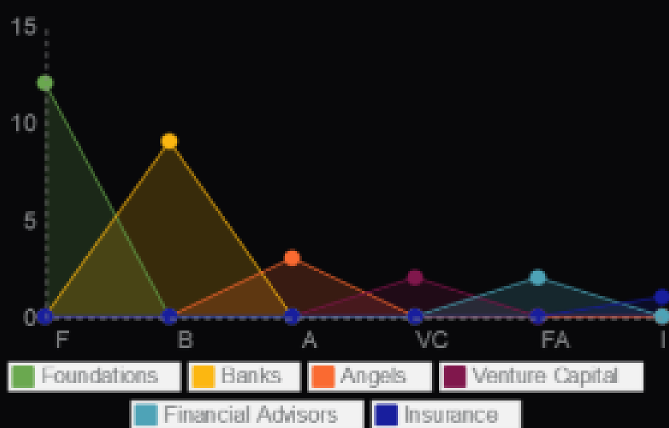
Philanthropy also emphasized that achieving outcomes was important. Additionally, many foundations around the country, often at the behest of donors, are moving in the direction of mission-based investments. In spite of this fact, every foundation interviewed stated that grants still encompass the vast majority of their philanthropic giving. Therefore, there lies an opportunity to not only assist private foundations facilitate mission-based investing, but there is also the unique prospect of helping

U.S. SIB MARKET

The current SIB market in the United States totals $83.5M USD in upfront investments, including grants, making the U.S. SIB market the largest in the world. The most promising markets thus far have been Early Childhood and Recidivism, both accounting for a collective total of $74M USD.

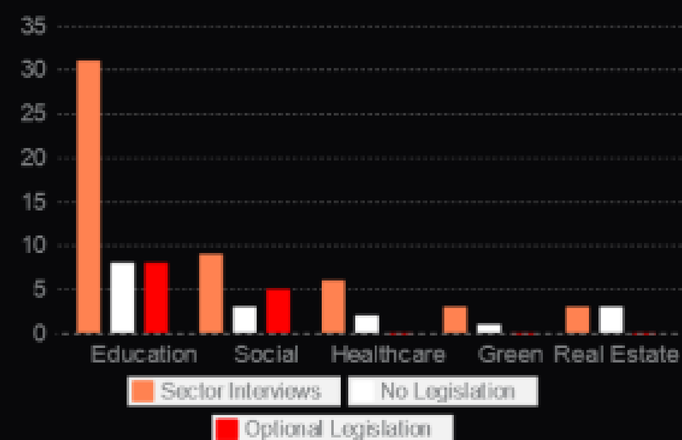


Financial Sector Interviews



Out of the various financial sectors interviewed, the most interest came from the Banking Sector, with 55% of banking institutions expressing interest in Social Impact Financing through the Community Reinvestment Act.

Impact Sector Interviews



The most promising sector for the Micro-SIB model was Early Childhood (EC), with 20 out of 22 EC organizations communicating a strong desire for Social Impact Financing.

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For more information concerning our design and social impact financial services, please contact Infinite 8 Institute at info@infinite8insttute.com turn existing charitable contributions into outcome-based transactions.

Also, many foundations interviewed do not necessarily have the on-staff expertise to determine what programs adhere to national or international best-practices. There also was an expressed need for intermediaries to build relationships with promising organizations to gain awareness of what is working, and the true state of affairs on the ground.

Essentially, each side of the market must have a meeting of the minds, and because each role is tightly interconnected, one role or sector cannot be ignored over the other. The research findings suggest that this delicate balance is one that is extremely important to master, and must be mastered if social impact financing, specifically Macro-SIBs and Micro-SIBs are going to be facilitated in a way that is fair, investor friendly, and provides every participant with something of sufficient value.

Potential Investors

Among potential investors, a total of 15 interviews were conducted among organizations within the financial industry. The majority of organizations interviewed were within the banking sector. Of those banking institutions interviewed, 55% of respondents expressed a strong interest in investing in social impact financial transactions. While acknowledging that banking institutions such as Northern Trust and Goldman Sachs have received Community Reinvestment Act (CRA) credit, the vast majority of banking executives had little knowledge concerning the intricacies of the CRA. Banking executives also stated that it would benefit the industry for the Federal Deposit Insurance Corporation (FDIC) to issue an official statement concerning their position on Social Impact Financing vehicles, such as the SIB structure, to help speed up the creation time and mainstream adoption of such transactions.

Among the twelve private foundations interviewed, there were none who had engaged in leveraging the capital or expertise of angel investors or venture capital. With the average venture capital investment of between $1.2M and $1.5M dollars nationally, and the average angel investment of $800k, there lies a unique opportunity to utilize social impact financing to bridge the divide between where angel investors max out monetary resources, and Venture capital begins.[9][10]

The financial advisor industry was also of interest. Advisors who were interviewed communicated an average investor portfolio size of $50,000 in assets. Advisors also stated that investors do indeed inquire about socially responsible investments. For example, from our research the top stocks advisors mentioned that investors stay away from are those that involve tobacco and alcohol. Green industry and sustainable energy were among those stocks that were highly sought after. Once again the main theme centered on the position that investors want to make a profit, and any investments must make good economic sense, and if they can benefit the community and the environment in the process, then such benevolence was an added benefit. Advisors also mentioned the necessary element of education, in order to create awareness among

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[9] Veghte, Ben, Chachere, Clare, Davidson, Jeffrey. "Annual Venture Capital Investment Tops $48 Billion in 2014, Reaching Highest Level in Over a Decade, According to the Money Tree Report." *NVCA.* 16 January 2015. Money Tree Report. Web. 7 September 2015. http://nvca.org/pressreleases/annual-venture-capital-investment-tops-48-billion-2014-reaching-highest-level-decade-according-moneytree-report/.

[10] Wiltbank, Rob. 2014 Annual ARI Halo Report." Angel Resource Institute. 15 April 2015. *ARI Halo Report.* Web. 7 September 2015. http://www.angelresourceinstitute.org/Research/Halo-Report/Halo-Report.aspx.

the financial industry regarding social impact investment opportunities and how they work.

Furthermore, the insurance industry presented attractive opportunities. Among those interviewed in the insurance industry, executives expressed an interest in participating in Social Impact Financial transactions, particularly in a risk management capacity, in order to provide insurance to cover the loans provided by investors, as well as mitigating the risk of such new and unexplored transactions. The future role of the insurance industry in the creation and implementation of SIBs will likely be a natural progression as the SIB industry evolves.

The State of Social Impact

The primary purpose of conducting research in the form of interviews has been to gain a sense of the state of social impact nationally and internationally. Among the many findings was a strong need among service organizations for expert consulting. Many organizations interviewed desired consulting concerning the design and finance of these often complex social impact financial structures. There was also a request for program development. Many service providers lacked the time or expertise to build and design programs capable of receiving the type of large financial contributions often associated with SIBs. Of those organizations interviewed, 35% stated that the provision of social impact consulting was important, while 30% stated that program development and design services was a significant need in order to build capacity. A surprising request was a desire for expert advocates who are knowledgeable concerning social impact financing, and who have the ability to articulate a business case as well as have an understanding concerning the intricacies and language of the social and environmental sectors.

Private foundations also expressed concern regarding the state of the global economy. Many of these entities are not waiting for the market to correct itself, or for donors to pull back. They are looking for stability, and they want to ensure that their investment have impact and are on target. While these organizations are interested in social impact investments there is an expressed lack of practical knowledge concerning SIB instruments at the community level, and also a lack of access to larger well-established wealth holders, intermediaries, and banking institutions.

Barriers to Entry

Organizations interviewed expressed a number of barriers faced in their efforts to create SIBs. The number one barrier by far was the passing of state or municipal legislation in order to gain government approval to move forward with the implementation of a desired SIB. Of the total organizations interviewed, 52% requested no government involvement in the creation of these transactions, while 48% requested that government involvement be optional but not a necessary requirement. Further relevant commentary from stakeholders consisted of complaints of bureaucratic inefficiency and politics as other top reasons for desiring private financing in the creation of social impact financial transactions.

Outcomes as Credit

Another complaint of service providers consisted of a lack of access to resources. Credit and other sources of financing have been limited for many service providing organizations. For example, in the sustainable energy field, the capital requirements for entry into the solar market remain fairly high. Many organizations lack the resources to enter the market and compete. A realization reached concerned the use of an organizations existing outcomes as a credit enhancing tool for service providers who are already achieving quantifiable outcomes, and can show they have consistently achieved benchmarks. The existing outcomes of these organizations can serve as credit in social impact transactions due to the profitability of these transactions entirely hinging on the achievement of successful outcomes, which many organizations already have a track record of accomplishing.

Corporate Social Responsibility

In an effort to discuss the role of Corporate Social Responsibility (CSR) in engaging with the social impact sector, zero interviews yielded positive feedback concerning corporate involvement in social impact financial transactions. Through engagement with the business community, primary responses concerning the topic consisted of a determination that corporations are currently sitting on the sideline regarding SIBs. Reasons cited range from the fact that the $80M industry is extremely small compared to other industry opportunities where profit is the sole purpose, to the ineffectiveness of stakeholders to articulate a strong business case for corporations to become more involved. However, industry insiders believe that as a result of the large amount of stagnant and non-performing capital that corporations are currently sitting on, it is likely that within the next 5-10 years more corporations will become involved if the sector proves successful.

EMERGING FINANCIAL INSTRUMENTS

In our highly evolving and complex global society, there have been a number of technological and social advances that have the possibility of disrupting the financial industry as well as social services. A few of these advancements have made headlines around the world as possible solutions or tools to address the many issues currently being grappled with by philanthropy and service providers around the world. During our interviews, we took the opportunity to test the applicability, relevance, and potential of a few of these emerging financial instruments.

Bitcoin

Bitcoin has been highly touted as the next big thing in the financial sector. While the digital currency has primarily been utilized as a safe-haven in times of economic uncertainty, similar to gold, the promise of the currency extends much beyond that. The true value for the social sector concerning Bitcoin can be tied to it's low-remittance fee's, which are as low as .01% for global currency transmissions.

In the field of philanthropy, particularly international philanthropy in third world countries that are worn-torn and strife with violence, Bitcoin offers a safer and faster way to ensure that a larger percentage of donor dollars are going where they are needed most. Exploring the possibility of utilizing Bitcoin within the framework of Micro-SIB's, we conducted experiments interviewing not only the current 101 global thought leaders, but we additionally surveyed over 100 consumers concerning the digital currency. Out of the 100 global thought leaders, none of them were utilizing Bitcoin. Furthermore, out of the 100+ consumers interviewed, none of them were utilizing digital currency.

In spite of larger numbers of merchants signing up to facilitate Bitcoin transactions, no one was actually utilizing the digital currency as "currency" on the ground. Among investors, there was no substantial knowledge concerning the digital currency as well. While the digital currency presents hope for its utility in the future, as of now it has not proven to have a strong relevance or practicality.

Equity Crowd-funding

Equity crowd-funding has become legal for not only sophisticated investors but also non-sophisticated investors in the United States during the first-half of 2015. Regulation IV/A+ of the Jobs Act, allows companies to raise up to $50M through non-accredited investors.

Accredited investors have been able to engage in equity crowd-funding since 2013.[11]

With the popularity of non-equity or prize-based crowd-funding, the possibilities of utilizing equity-crowdfunding as a tool to finance Micro-SIBs made sense. However, what the research presented was not as promising. Out of the 101 interviews conducted, only one organizations was engaged in equity crowd-funding, having created an online platform. Additionally, the sole organization who was engaged in the fairly new method of raising capital online, was located in the UK, where investors stood to recoup anywhere from 30%-50% of their initial investment as a result of tax incentives.[12] Additionally, among actual investors interviewed, there were none who had utilized online equity crowd-funding for investments purposes within the last year.

As a result, although equity crowd-funding may be transforming how investors conduct transactions in Europe, the average investor in the United States is still utilizing traditional means to make investments. Therefore, it has been deemed in the best interest of simplicity to forgo equity-crowdfunding as a component of the Micro-SIB model.

A CASE FOR CULTURAL COMPETENCY: RIKERS ISLAND FAILED SIB

According to the interviews and research conducted in the field of social impact investing, it has been found that the creation of SIBs has so far been relegated to a small group of individuals and organizations, with little experience implementing social and environmental programming at a grassroots level. Of the five individuals interviewed who have actually worked on SIBs, four admitted a need for diversity of perspectives and community-based inclusion in these transactions in order to maximize their ultimate success.

The outcome of the Rikers Island SIB, where the service providers failed to meet projected benchmarks by implementing Moral Reconation Therapy (MRT), which is a systematic treatment strategy that seeks to reduce recidivism among juveniles and adult criminal offenders by increasing moral reasoning, serves as a perfect case study concerning the need for cultural and professional competency in order to achieve desired social outcomes.[13] Opponents of the Rikers Island SIB point to it as a failure of the entire SIB model, while proponents point to its failure as a success, due to the discovery that the methodology of MRT did not work on the target population.

However, with 95% of New York prisoners identifying as Black or Latino, diligent research would have revealed that MRT, previously proved ineffective with African American populations, according to a 2009 study, which revealed that through independent testing, comparing the recidivism among control and treatment groups exposed to MRT, it resulted in no significant differences with regard to recidivism, further concluding that MRT did not significantly reduce recidivism for the juvenile offenders of the study.[14] A closer look also

[11] Barnett, Chance. "SEC Democratizes Equity Crowdfunding With JOBS Act Titlve IV." *Forbes.* 26 March 2015. Web. 7 September 2015. http://www.forbes.com/sites/chancebarnett/2015/03/26/infographic-sec-democratizes-equity-crowdfunding-with-jobs-act-title-iv/2/.

[12] "Tax Incentives." *HBAN.* HBAN, 5 May 2015. Web. 7 September 2015.

[13] "Moral Reconation Therapy." *NREPP.* NREPP, 1 May 2008. Web. 7 September 2015. http://www.nrepp.samhsa.gov/Viewintervention.aspx?id=34.

[14] Behrens, Courtney. "Evaluating the effectiveness of Moral Reconation Therapy with the juvenile offender population 2009". *Iowa State Univeristy*. Graduate Theses and Dissertation. Paper 11070 (81). http://lib.dr.iastate.edu/cgi/viewcontent.cgi?article=2099&context=etd.

would have revealed that analogous studies found similar unsuccessful results.[15] Juvenile offenders participating in the Rikers Island SIB, also did not receive wrap around services upon reentry into the civilian population, whose provision may or may not have changed the outcome of the SIB initiative.

STANDARD VS. COMMUNITY-BASED METRICS?

A large question that became a central conversation throughout the interviews was the provision of a widely accepted set of standard metrics, or whether metrics should be left to be negotiated at the community level. The vast majority of interviewees felt strongly that there should be a minimal set of metrics, providing an outline for stakeholders to build off of. However, it was clear among a majority of interview participants, that any Micro-SIB transaction must be flexible enough for community stakeholders to not only choose from existing metrics, but they also must allow stakeholders the ability to insert customized metrics that are specific to their community needs and geographical preferences.

As a result, the Micro-SIB will continue to utilize the IRIS Metrics as a bare framework, providing standard metrics for a variety of fields to build off of, while also encouraging stakeholders to exercise freedom of discretion regarding the customization and implementation of community-based standards. Therefore, the local negotiating table will have the final say concerning the ultimate determination of project metrics.

RELEVANT LEGISLATION

Federal Legislation

Social Impact Partnership Act (H.R. 1336) – On March 4, 205, U.S. Representatives Todd Young (R-IN) and John Delaney (D-MD) – along with eight other bipartisan cosponsors reintroduced H.R. 1336, which would create a one-time $300M fund at the Office of Management and Budget to support the development of new social impact bond deals at the state and local level over the next 10 years.[16]

Social Impact Partnership Act (S. 1089) – On April 27, 2015, U.S. Senators Orrin Hatch (R-UT) and Michael Bennet (D-CO) reintroduced a companion bill to H.R. 1336, the Social Impact Bond Partnership Act (S. 1089), which would create a $300M fund at the U.S. Treasury to support PFS at the state and local level.[17]

Every Child Achieves Act (S. 1177) – On July 16, 2015, the U.S Senate passed legislation that would reauthorize the Elementary and Secondary Education Act (ESEA), (1) which would allow states and local school districts to invest in their Title I, Part D funds (Programs for Neglected, Delinquent, and At Risk Children and Youth, $47.6M in FY15) in PFS initiatives; (2) allow local school districts to invest their Title IV, Part A funds (Safe and Drug Free Schools and Communities, $70 million in FY15) in PFS initiatives; and (3) allow states to invest their early childhood coordination funds (Early Learning Alignment and Improvement Grants, newly authorized program) in PFS initiatives.[18]

The Student Success Act (H.R. 5) – On July 8, 2015, the U.S. House passed its ESEA reauthorization bill – H.R. 5, the Student Success Act, which would (1) allow states and local school districts to invest their Title II, Part A funds (Teacher Preparation and Effectiveness, approximately $2.3 billion in FY15) in Pay for Success initiatives; and (2) would allow states and local school districts to invest their Teacher

[15] Armstrong, T.A. (2003). The effect of Moral Reconation Therapy on the recidivism of youthful offenders. *Criminal Justice and Behavior*, 30(6), 668-687.

[16] H.R. 1336, 114th Cong. (2015).
[17] S. 1089, 114th Cong. (2015).
[18] S. 1177, 114th Cong. (2015).

and School Leader Flexible Grant Funds (a new program authorized at $697 million) in PFS initiatives.[19]

Workforce Innovation and Opportunity Act (WIOA) – On July 22, 2014, President Obama signed the WIOA into law. This bipartisan legislation, authorizes the three largest federal workforce development programs (Youth Workforce Investment program, Adult Employment and Training program, and Dislocated Workers Employment and Training program), which includes new provisions which: (1) increase the amount of WIOA funds can set aside and distribute directly from 5-10% and authorize them to invest these funds in Pay for Performance initiatives; (2) authorize states to invest their own workforce development funds, as well as non-federal resources, in Pay for Performance initiatives (3) authorize local workforce investment boards to invest up to 10% of their WIOA funds in Pay for Performance initiatives; and (4) authorize states and local workforce investment boards to award Pay for Performance contracts to intermediaries, community based organizations, and community colleges.[20]

Second Chance Act – Through the U.S. Department of Justice' Second Chance Act, whose program goals are to "reduce recidivism, provide reentry services, conduct research, and evaluate the impact of reentry programs." The FY14 and FY15 federal appropriations bills also authorized the Department to invest up to $7.5M of its Second Chance Act funds in Pay for Success efforts, including $5M to implement projects using the Permanent Supportive Housing model.[21]

Corporation for National and Community Service – FY16 and FY15 Federal appropriations bills authorized the Corporation for National and Community Service (CNCS) to invest up to 20% of the Social Innovation Fund (SIF) (up to $14 million) in Pay for Success initiatives. Key focus areas include: economic opportunity, healthy futures, and youth development. Federal grant dollars must be matched by the grantee with nonfederal dollars and services.[22]

U.S. Dept. of Housing & Urban Development – The Obama Administration's FY16 Budget request seeks demonstration authority allowing the U.S. Department of Housing & Urban Development (HUD) to use PFS deals to finance energy efficiency retrofits in HUD-assisted housing through reduction in utility costs.[23]

FY16 Total Proposed Exec. Budget = $364M

U.S. FEDERAL TAX INCENTIVES

New Market Tax Credits (NMTC) – The New Market Tax Credit program stems from the Community Renewal Tax Relief Act of 2000, which to date has allocated $29.5B in investments to privately management investment institutions. Through the creation of Community Development Financial Institutions (CDFIs), who privately administer raised capital for Micro-SIBs, investors are able to recoup tax credits of up to 39% of their cash equity investment over a period of seven years (5% in years 1-3, and 6% in years 1-3).[24]

Low-income Housing Tax Credits (LIHTC) – The LIHTC program was created in 1986 to encourage private investment in the development and rehabilitation of rental

[19] H.R. 5, 114th Cong. (2015).
[20] H.R. 803, 113TH Cong. (2014).
[21] H.R. 1493, 110th Cong. (2008).
[22] "National Service Agency Announces $12M to Support Pay for Success Projects. *NCS.* NCS, 1 October 2014. Web. 7 September 2015.

[23] "Improving Outcomes through Pay for Success." *White House.* White House, 13 April 2015. Web. 7 September 2015.
[24] "New Markets Tax Incentive Program." *CDFI*. CDFI. 3 September 2015. Web. 7 September 2015. http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=5.

housing for low to moderate-income families, seniors, and persons with special needs. LIHTCs are governed by Section 42 of the Internal Revenue Code and corresponding Federal Regulations. Tax credits under the LIHTC program are transferrable and able to be sold to investors for capital or equity. The aim of the legislation is to provide lower rents that are affordable for low-income and moderate-income households, while giving investors' tax breaks that exceed their total investment in the real estate.[25]

Consumer Energy Efficiency Tax Credits – Under the Tax Increase Prevention Act of 2014, eligible consumer items, such as Geothermal Heat Pumps, Small Residential Wind Turbines, and Solar Energy Systems, provide tax credits for up to 30% of the cost, up to $500 per .5 KW of power capacity. Existing homes and new construction do qualify. Rental homes and second homes do not qualify.[26]

Losses on Sale of Small Business Equity – Under IRS 1244, investors' who invest in a company with less than $1M in assets – and lose their investment, may be able to write off the loss as an ordinary loss rather than a capital loss, which allows investors to write off up to $50,000 in losses on a qualified domestic corporation. This in turn can be used to reduce an investor's ordinary income, which otherwise would be taxed at a maximum rate as high as $39.6%.[27]

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[25] National Association of Home Builders, *The local Economies Impact of Typical Housing Tax Credit Developments (March 2010).*

[26] "Federal Tax Credits for Consumer Energy Efficiecy." *Energy Star.* Energy Star, 30 October 2013. Web. 7 September 2015. https://www.energystar.gov/about/federal_tax_credits.

[27] 26 U.S.C. Sec. 1224 (1958). https://www.law.cornell.edu/uscode/text/26/1244,

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