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New funding tool could spur nonprofit innovation

The latest state budget earmarks \$30 million for the expansion of social-impact bonds, a philanthropic investment option.

[Theresa Agovino](#)

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Since being released from prison three months ago, Louis Rivera has found an apartment, landed a job and started applying for college. It's a sea change for the 19-year-old, who was incarcerated for about two years for attempted burglary and had a history of dealing drugs, running with a gang and stealing. He credits a therapy program at Rikers Island provided by the Osborne Association and Friends of Island Academy for helping him get his life on track.

"I realized that I could have a better life," said Mr. Rivera. "I learned to forgive myself for what I'd done and others for hurting me."

Mr. Rivera's therapy was paid for by an unusual funding mechanism known as a social-impact bond—an innovation that's becoming more prevalent in New York social-service and philanthropic circles. Announced by the city in 2012, Rikers' therapy program, aimed at reducing juvenile recidivism, was the nation's first social-bond initiative.

Last December, New York introduced the first state-led plan in the U.S. It also aims to keep ex-offenders out of prison. The recently passed state budget earmarked \$30 million for additional social bonds, and last month the state announced that four programs are under consideration for funding. Three are slated to work with New York City residents.

In a social bond, a government agency sets goals to fix a problem, and taps an outside expert to enlist a nonprofit to meet the objectives and raise money from private and philanthropic investors to fund the initiative. The government only repays investors if the program succeeds. If a program designed to reduce hospitalizations, for example, achieves its goal, investors will be paid with the money saved on patient care.

"These pay-for-success programs make a lot of sense because it's an opportunity to expand social services to people who might not otherwise get them, and is an innovative structure that encourages public-private partnerships," said Ian Rosenblum, New York state's deputy secretary of education and economic opportunity and the point man on social-impact bonds. "This way, we are paying for results, not just paying for the process."

Mr. Rosenblum said that in the coming weeks, the state will begin negotiating with the four contenders. He expects two or three to be selected. One program is jointly sponsored by the Children's Aid Society and the Bronx's Montefiore Medical Center to reduce teen pregnancy rates and improve asthma care.

The bonds will never replace private fundraising and government aid, nonprofit executives say, because not all social programs have quantifiable results. Experienced charities with a history of success are sought after for partnerships.

'LOW-RISK' EFFORT

"This is paying for us to do what we do," said Sam Schaeffer, chief executive of the Manhattan-based Center for Employment Opportunities, which is running the New York state program for ex-offenders set up by Social Finance U.S. "It is fairly low-risk for us."

Known as CEO, the nonprofit has a proven track record of reducing recidivism and finding employment for the previously incarcerated through counseling and job training. That can help solve a costly problem for the state. New York released nearly 24,000 people from prison last year, and 41% of those formerly incarcerated return within three years. It costs \$60,000 annually to imprison someone in New York state.

Under the terms of the agreement, CEO expects to work with 2,000 individuals and seeks to reduce their recidivism rate by at least 8% and boost their employment rate by 5 percentage points.

If the project cuts recidivism by 15% and increases employment by 5 percentage points, the total public-sector savings would be \$17.2 million, according to a state spokesman. Investors would be paid \$15.7 million, representing a 4% annualized return on their investment.

Bank of America Merrill Lynch raised \$13.5 million from more than 40 individuals and philanthropic foundations to fund the five-and-a-half-year-long program.

"We were hearing from our clients who wanted investment options that would represent their values," said Liam O'Neil, managing director and head of the markets group for Bank of America Merrill Lynch.

The payoff isn't huge: Returns on investment are capped at 12.5%. Mr. O'Neil expects it will likely be more mid-single digits. Meanwhile, the Rockefeller Foundation agreed to guarantee 10% of the \$13.5 million so investors won't lose everything if the program fails.

CHALLENGING WORK

In the city's Rikers Island-program, which was set up through social-policy organization MDRC, Bloomberg Philanthropies agreed to repay \$7.2 million of the \$9.6 million put up by Goldman Sachs' Urban Investment Group to provide cognitive behavioral therapy to 16- to 18-year-olds if that program fails to reduce recidivism. Recidivism must fall by at least 10% for investors to be repaid.

Elizabeth Gaynes, Osborne's executive director, said working with adolescents at Rikers is challenging because time with them can be limited. Yet, she said, feedback from participants has been good, and according to the city's Department of Correction, the number of adolescent admissions at Rikers last year dropped 17%, to 3,935, from 2012.

"If the program doesn't work, it could affect our reputation," said Ms. Gaynes. She doesn't expect that to happen, but adds that the therapy is still helping the children. "We aren't doing any harm," she said.



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