Private Investments in Public Preschools

Issues in the Use or Non-Use of Estimated Cost Savings in Pay-for-Success Contracts

Judy Temple
Humphrey School of Public Affairs, University of Minnesota

Steps in social impact financing through a Pay-for-Success contract

(sometimes called social impact bonds SIBS, a misnomer)

1. Identify what social, educational, or health services are effective and actually save governments more money than they cost. Ex. Programs for recidivism prevention, supportive housing, early childhood interventions

2. Find private investors willing to spend $5 to $20 million or more to expand promising social services at the state or local level.

3. Identify "success targets" – indicators that the services are generating cost savings to governments. Examples: reduction in jail days, reductions in special education placement rates, reductions in emergency room visits.

4. Governments pay back private investors when the projects meet the targets for success.

Focusing on early childhood interventions, we know from previous CBAs that well-targeted interventions may generate social benefits in excess of costs

Ex. Monetizable benefits of preschool in chronological order

1. reductions in special education spending
2. reductions in juvenile justice costs
3. reductions in education costs due to grade retention
4. increases in tax revenues to higher ed attainment
5. increases in private earnings of preschool participants
6. reductions in administrative costs associated with welfare programs
7. reductions in costs associated with adult crime

Three examples of recent U.S. social impact PFS initiatives

Initiatives	Private investment	Outcomes triggering success payments
NYC ABLE project for incarcerated youth at Riker's Island	$9.6 million	Number of jail days avoided relative to a comparison group
Utah High Quality Preschool Program	$4.6 million	Reductions in rates of placement in special education through gr. 6
Chicago Child-Parent Center early education program	$16.9 million	Reduction in special education placement relative to comparison group through gr. 12. Increase in K and 3rd grade scores.

In addition to the private investors and the government partner, three other parties are involved

- (1) Philanthropists provide funds to *guarantee the investment* and may help pay for the administrative or evaluation costs.
- (2) Outside evaluator conducts the impact assessment with a rigorous study design specified in the contract.
- (3) Intermediary – oversees provision of services and the outside evaluator and ensures that success payments are made.

For preschool PFS initiatives, a major source of cost savings in the near term is a reduction in special education costs.

If success is defined primarily as reductions in special education rates (relative to a comparison group),

- Need to make sure that the availability of incentives does not induce service providers to misrepresent their effectiveness.
- School districts could claim success by simply choosing not to provide children in special education services.
- Ideally should observe preschool's effects on kindergarten readiness and third grade test scores as well.

PFS for the Chicago Child Parent Center early education program

- Was the first to move from Paying for Success arising from government cost savings to Paying for Desired Outcomes not explicitly connected to cost savings.

Success payments:

- The School District agrees to pay $9,100 per child per year for avoidance of special education placement. This payment is based on the district's estimated cost savings.
- The City of Chicago also agrees to pay $2,900 for each child make "kindergarten ready" and $750 per student for meeting proficiency targets in grade 3.

Additional PFS-funded preschool initiatives have received feasibility grants to start moving them toward implementation

- The federal ESSA (Every Student Succeeds Act) encourages the use of PFS in expanding promising education services.
- New federal Preschool Development Grants program made 7 feasibility grant awards of $300-400K to local or state organizations to help bring promising projects to scale.
- The 7 awardees proposed high-quality programs that were likely to cause improvements in kindergarten readiness, school attendance, special education avoidance, and socio-emotional learning outcomes.

Feasibility grants awarded for pre-k PFS studies (Dec. 2016)

Grantee	Preschool outcomes	Potential payors mentioned
Clatsop County, OR	Academic and socio-emotional outcomes at end of pre-K, attendance, **special educ.**, behavior referrals, 3rd gr. reading	County, school districts, regional Medicaid provider
Cuyahoga County, OH	Academic and socio-emot at end of pre-k, grade retention, 3rd gr. reading,	County and "other stakeholders"
Legacy Charter School, SC	Academic and socio-emotional outcomes at end of pre-K	To be determined
Mecklenberg County, NC	Academic and socio-emot at end of pre- and through gr. 3, retention, absenteeism, behavior referrals, early warning system for school dropout	To be determined
Minnesota Department of Education	Academic and socio-emot at end of pre-k and through gr. 3, **special ed.**, retention, behavior incidents, absenteeism, teacher turnover	State and/or school districts
Napa Valley School District, CA	Academic and socio-emot and ipad proficiency at end of pre-k, academic outcomes through gr. 3 including ELL	School district
Santa Clara County, CA	Academic and socio-emot. measures of K readiness, reading and math in gr. 3, absenteeism, **special ed.**, ELL language outcomes.	Santa Clara School District
Ventura County, CA	Academic and socio-emot. learning at end of pre-k and academic outcomes in gr. 3	Local governments and state agencies TBD

Research on the determinants of costs to local governments

- Prevention of special education generates clear cost savings to school district, state and federal governments. (Not counties or cities)

- The cost savings associated with many of the other outcomes being promoted by PFS initiatives have little empirical support except in the long run.   Ex. 3rd grade test scores and county expenditures.

- Some early childhood initiatives promote health outcomes, and these may have a closer link to nearer-term county expenditures.

A cautionary tale as Pay for Success evolves

- Pay for Success based on desired outcomes not directly linked to current cost savings?
- I argue that there are unintended consequences that will ultimately limit the use of PFS and limit the interest of private investors.

Example

- As the County Executive or member of the city council, you are willing to pay $X for every child made "ready for K" and every child who performs at or above national norms on 3rd grade reading assessments.

- These are great outcomes to support, but they don't generate immediate or near-term cost savings for the county or the city.

- Assuming total revenues raised by the county or city remain unchanged, these success payments to private investors must be financed by reducing expenditures for other programs.

- Especially in an economic downturn, there will be criticism of payments made to investment banks while cutting Meals on Wheels or reducing the size of the police force or hours at the public library.

Paying for desirable outcomes that don't generate cost savings

- Assuming total revenues received by the payor government do not increase, expenditures on other items in city or county budgets must be reduced if success targets are met.
- In Minnesota's PFS pilot, clear language exists in legislation requiring reductions in an agency's appropriations in order to make pay for success payments to investors.
- In contrast, if success payments represent realized cost savings to the payor government, then spending in other budget categories can remain unchanged.

Specific risks created by paying for desirable outcomes vs. paying for outcomes that generate government cost savings

- Political risk (Burand, 2013)- will these promises to make success payments (and reduce other components of the budget) be agreeable to agency heads and taxpayers in the future?
- Appropriations risk as a type of political risk – will the payor government allocate enough funds to pay the investors if no cost savings are realized but success targets are met?
- Chicago's PFS contract includes specific language stating that credit ratings agencies will be notified if required payments are not made.
- Ways to mitigate appropriations risk: pre-paid sinking funds, authorization of multi-year appropriations.

In conclusion, social impact financing via PFS contracts

- Provides additional funding to expand preventative social or educational programs that not only help people but save governments more money than they cost.
- Emphasizes the importance of evidence-based programs and the role of impact evaluation and cost-benefit analysis.
- However, the movement away from success payments based on realized cost savings to success payments made for achieving desirable outcomes is likely to make PFS initiatives less attractive to private investors due to higher risk and will limit the size of these projects.