Date of Hearing: April 22, 2014

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE ECONOMY
Jose Medina, Chair
AB 1837 (Atkins) – As Introduced: February 18, 2014

SUBJECT: Governor's Office of Business and Economic Development

SUMMARY: Requires the Governor's Office of Business and Economic Development (GO-Biz) to lead the state's efforts in expanding the use of social innovation financing and performance-based contracts to address significant social issues, including, but not limited to, homelessness, prison inmate recidivism, and workforce development. Specifically, this bill:

1) Expresses findings and declarations including, but not limited to, that it is the intent of the Legislature to establish partnerships between government agencies, private investors, nonprofit organizations, and for-profit service providers in order to facilitate the use of social innovation financing to achieve social benefits.

2) Requires GO-Biz to serve as the lead entity for the state's efforts to explore social innovation financing and provide technical assistance for local governments that are exploring the creation of social innovation financing.

3) Requires GO-Biz to develop model provisions for performance-based contracts.

4) Defines "performance based contracts" to mean contractual agreements between government, private investors, and service providers where private investors agree to provide up-front financing to service providers to achieve pre-agreed upon social outcomes and the government agency agrees to pay a return on investment (ROI) to the investors if successful programmatic outcomes are achieved by the service provider.

5) Defines "social innovation financing" to mean an investment arrangement using private funding to finance a social program administered by a nonprofit organization or a for-profit service provider on behalf of a government agency pursuant to a performance-based contract.

EXISTING LAW establishes GO-Biz within the Governor's Office for the purpose of serving as the lead state entity for economic strategy and marketing of California on issues relating to business development, private sector investment, and economic growth.

FISCAL EFFECT: Unknown

COMMENTS:

1) Author's Purpose: According to the author, "In times of economic uncertainty, ongoing budget liabilities, and volatile revenue streams, one of the biggest challenges government encounters is finding upfront resources to invest in innovation. Even when innovative strategies have proven to be successful through research, pilot programs, and data, finding upfront investment to expand successful programs amidst competing priorities proves to be an enormous barrier. The unfortunate reality is California misses out on improved outcomes that save governments and taxpayers’ money simply because we can’t find the startup money to fund successful intervention.

California should be open to tools that encourage more investment to accomplish measurable social benefit, save taxpayer money, and meet public policy goals. Social innovation financing is one such tool. By identifying the Governor's Office of Business and Economic Development as the lead entity for social innovation financing, AB 1837 sets California on a path to better tap into private and philanthropic resources, support local governments that are already exploring these partnerships, and take advantage of future federal funding for social innovation."

2) Framing the Policy Issue: This bill calls on GO-Biz to operationalize the use of social innovation finance and performance-based contracts to achieve measurable positive outcomes that address significant social and community challenges. In undertaking this charge, GO-Biz will also be responsible for providing technical assistance to local governments.

   In deliberating the merits of the measure, Members may wish to consider the state's limited resources to address complex social problems, and the significant amount of work that has already been done by impact investors, foundations, and other states on social innovation financing that would benefit California if they were more widely distributed. The analysis includes information on the current use of social innovation financing and performance-based contracting. Comment 7 includes amendment recommendations.

3) Federal Lessons on Performance-Based Contracting: Performance-based contracting is designed to ensure that contractors are given the freedom to determine how best to meet the government's performance objectives, while allowing governments to only pay for those services that meet the pre-determined quality and performance levels. This is not a new concept, but it is growing in popularity as governments face tighter budgets and become more open to using private sector innovations to address social challenges where "one size" will not fit all.

   Performance-based government service contracting was initially pioneered at the federal level in the early 1990s at the Department of Defense with, according to the Office of Budget and Management, a great deal of success. By the mid-1990s, the federal government, in partnership with four industry associations, initiated a number of pilot projects. Services covered ranged from janitorial and guard services to computer maintenance and aircraft technical support. As a result, 15 agencies converted 26 contracts with an estimated value of $585 million to performance-based methods. The agencies reported an average 15% reduction in contract price in nominal dollars, and an 18% improvement in satisfaction with the contractor's work. Moreover, "reduced prices and increased customer satisfaction occurred at all price ranges, for both nontechnical and professional and technical services. [*A Report on the Performance-Based Service Contracting Pilot Project," May 1996*]

   Although a documented success, this early research also identified a number of key challenges government faced when using performance-based contracts, including identification of which service contracts were best suited to the model, preparation of a sufficiently focused statement of work, and ensuring quality standards were being met. Under AB 1837 GO-Biz will examine these types of issues and make recommendations on how state agencies can best move forward in performance-based contracting

4) Innovating Performance-Based Contracts: As you will see in this example from Massachusetts, the next generation of contracting is performance-based in order to address larger social challenges and often includes new methods for funding including social impact bonds (SIBs). AB 1837 uses this tri-party innovation finance model as the definition of performance based contracts.

Under the tri-party innovation finance model, government sets the task and measurable objective, which a service provider (social entrepreneur) agrees to meet with upfront funding by a private sector investor, which may be a foundation or other socially responsible investor. If the social entrepreneur is successful in achieving the measurable objective, the government pays the investor, usually at a premium rate. If the measurable outcome is not achieved, no government money is expended. As an emerging financing tool, there is often a need for a community intermediary that is responsible for linking the three parties together.

In 2012, Massachusetts announced plans to use social innovation financing to address two challenging problems: Chronic homelessness and high recidivism rates among juvenile offenders. Supporters of these initiatives described the use of social innovation financing as directing "government funds toward smart initiatives that deliver real-world results." More details on these two initiates are described below.

- Chronic Homelessness – Massachusetts will partner with social entrepreneurs to provide stable housing for several hundred chronically homeless individuals. The goal of the initiative is to improve the well-being of the individuals while simultaneously reducing housing and Medicaid costs.

- Juvenile Justice – Massachusetts will partner with social entrepreneurs to support youth aging out of the juvenile corrections and probation systems and to help them in making successful transitions to adulthood. The juvenile justice contract will be designed with the specific goal of reducing recidivism and improving education and employment outcomes over a 6-year period for a significant segment of the more than 750 youth who exit the juvenile corrections and probation systems annually.

Currently, several other states and local governments have already initiated or will be initiating projects that include performance-based contracting models including:

- New York City, which is seeking to reduce recidivism among young adults;
- The State of Minnesota, which wants better outcomes relative to workforce development and supportive housing;
- New York State, which is addressing recidivism through employment opportunities for high-risk adult and juvenile ex-offenders re-entering society; and
- The City of Fresno, in partnership with the California Endowment, which is seeking solutions that reduce incidents of asthma.

5) Recent Federal Activity: In 2013, the U.S. Department of Labor awarded nearly $24 million in pay-for-success (PFS) grants, which are one type of performance-based contracts, to states including New York State receiving ($12 million) and Massachusetts ($11.67 million). Both grants were intended to capitalize SIB issued by the states for projects that increase employment and reduce recidivism among formerly incarcerated individuals.

President Obama's FY2014 budget proposed expanding the federal government's support for PFS initiatives, reserving up to $195 million for programs in the areas of job training, education, criminal justice, housing, and disability services. The President's FY2014 and FY2015 Budgets have also proposed a $300 million incentive fund at the Department of the Treasury to help state and local governments implement PFS programs in partnership with philanthropies. In January 2014, the White

House Office of Science and Technology Policy released a Request for Information designed to accelerate the development, evaluation, and adoption of high-impact learning technologies using "pull mechanisms," including PFS-based contracts.

All this suggests that additional federal funds will become available. California should be ready to access these moneys in a manner that is thoughtful and appropriate for the state.

6) The State's Administrative Role in Social Innovation: The core strength of performance-based contracting is that it puts government in the position of objectively evaluating performance. By clearly defining the set of numbers and other metrics against which success will be measured, personalities and other subjective influences are taken out of the contracting equation.

At first glance, the shift to performance-based contracting would appear to remove a large share of responsibility from the government. The reality, however, is that the state's responsibilities under a pay-for-performance contract are not lessened, just changed. Under a solutions-based approach government procurement officials must be more clear about their ultimate objectives, set a specific benchmark and measurable metric, while still defining acceptable quality levels. Identifying these types of conditions often requires additional training of staff and, at least initially, closer oversight of contracting activity.

Other key parameters include identifying projects that are appropriate for performance-based contracts. The British government, who were some of the first uses of SIBs, offers the following list to its government officials who are considering the use of social innovation financing, such as PFS contracts and SIBs:

- Is the desired outcome clear and measurable at both the beginning and of the end of the contract so that progress can be easily measured?
- Can evidence be provided that the quality of the outcome is improved?
- Is there evidence that effective programs are available to meet the anticipated outcomes?
- Is the desired outcome appropriate for private sector solutions?
- Are there real financial savings, as well as social benefits?
- Is there a proper alignment between the government entity funding the contract and the financial savings that will be accrued?

Here is an example of how some of these principles might apply to a real project. The government's stated objective is to reduce recidivism of prison inmates. The statement of the work must therefore include, among other things, a clear and detailed statement about which formally incarcerated populations are the intended clients; what constitutes baseline and success (2% reduction or a 10% reduction); over what period of time; what costs are associated with the population for no action taking place; and if the recidivism rate drops, which government entities save money? If part of the objective is for the formally incarcerated individuals to become employed, then other issues need be specified, such as whether job training is included or is the task to find jobs at their current skill level, what salary level must be obtained, and do the jobs need to be part of established career ladders?

AB 1837 calls on GO-Biz to establish partnerships between government agencies, private investors, nonprofit organizations, and for-profit service providers to facilitate the use of social innovation financing to achieve measureable social benefits. As the state's leading agency in economic development and finance, GO-Biz seems to be well placed to bridge the private and public sector divide and develop a new California framework for utilizing social innovation finance models and performance-based contracting.

7) Technical Amendments: AB 1837 establishes a new duty for GO-Biz by designating it as the state lead on the use of social innovation finance and performance-based contracts. Additional programmatic details may be useful including, but not limited to:

   a) Add legislative intent related to the appropriate use of performance-based contracting.

   b) Direct GO-Biz to recommend implementation procedures for local governments and state agencies undertaking performance-based contracting. These procedures may include the importance of writing a clear statement of work, issues to address in the feasibility study, and how to set performance baselines and measurements of success.

   c) Establish an advisory committee to help guide the development of the initiative.

   d) Establish an account within the Economic Development Fund where moneys which have been committed to the successful completion of a performance-based contract can be held awaiting results.

8) Related Legislation: Legislation related to this measure includes the following:

   a) *AB 495 (Campos) California Community Investment Program*: This bill establishes the California Community Investment Program, within GO-Biz, for the purpose of assisting low-income neighborhoods attract private sector investment capital. Status: Pending in the Senate Committee on Business Professions and Economic Development.

   b) *SB 593 (Lieu) Social Impact Partnerships*: This bill requires the Governor's Office of Planning and Research (OPR) to conduct a Social Impact Partnership Pilot Program; and permits OPR to identify and submit proposed social impact partnerships to the Legislature for consideration with the May Revision of the Governor's Budget each year beginning in 2015. Status: Pending in the Assembly Committee on Rules.

REGISTERED SUPPORT / OPPOSITION:

Support

None Received

Opposition

None Received

Analysis Prepared by: Toni Symonds / J., E.D. & E. / (916) 319-2090