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Creating 21st Century Capital Markets for Better Social Outcomes: Transformative Change in Health Equity Through Debt Financing: Equity Increment Financing

Presentation at the New York Federal Reserve Bank on September 13, 2022

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Agenda

1. The Challenge
2. The Opportunity
3. Equity Increment Financing
4. Respondent Panel

The Challenge: Status of Child Health and Well-Being

- The COVID-19 pandemic placed extraordinary stressors on child well-being and has resulted in **education setbacks**, including the largest average score decline in reading since 1990, and the first ever score decline in mathematics.
- In December 2021, U.S. Surgeon General Dr. Vivek Murthy issued a new Surgeon General's Advisory to highlight the urgent need to address the nation's **youth mental health crisis.**
- In 2020, **gun violence** became the leading cause of childhood death.
- Children who are Black, American Indian or Alaska Native (AI/AN) often **face setbacks immediately in life** as evidenced by persistent racial disparities in maternal mortality, premature birth, and infant mortality.

The Challenge: Addressing the Needs Facing Children

- To address these growing **threats to long-term health and well-being**, new policies, programs, and strategies will be necessary - and this will cost money.
- **Substantive long-term investments** in child well-being **are challenging** to make from a public budgeting and political standpoint.
- Government **does not necessarily incentivize the interventions that will create the greatest impact** for children, especially as needs change.
- We must **target our public spending strategies** on emerging issues in health, education, and other areas if we want **to remain a leading nation**.

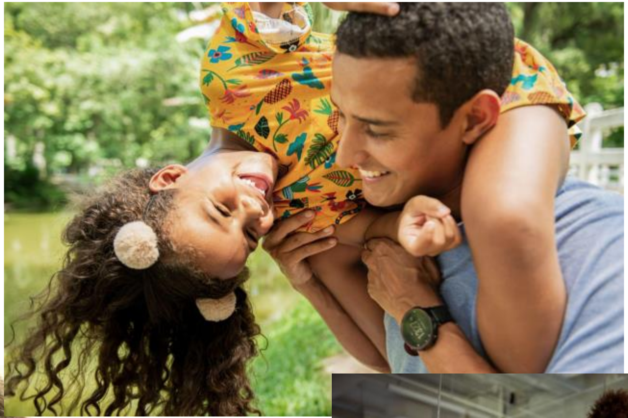
The Opportunity: Importance of Investing Early

- **Improving the environment, experiences, and relationships** of children early in life reduces rates of incarceration, homelessness, failure to complete high school, and many other societal challenges.
- **Two-generation approaches** that invest in the mother AND child create lifelong health, educational achievement, and economic prosperity.
- **High-quality early learning and development programs** for disadvantaged children prevent the achievement gap, boost lifelong earnings, improve health outcomes, and reduce utilization of public welfare programs.

The Opportunity: Substantive Ideas for Action

- Launch **comprehensive child development effort** (i.e. Harlem Children's Zone)
- Develop substantive response to **youth mental health crisis**
- Create community infrastructure to **address long-standing racial disparities**
- Enhance services around pediatric primary care to **support whole child health**
- Establish state-level child tax credit or baby bonds to **reduce poverty**
- Expand opportunities for high-quality **early care and education**
- Build **education and workforce initiatives** to improve economic outcomes
- ***Other proposals advanced by community members, including youth***

The Opportunity: Where do we go from here?



Equity Increment Financing: The Basic Idea

- Investments that improve children's health and well-being often pay for themselves over a long enough timeline and across enough domains of value.
- Equity Increment Financing would offer a bond that funds a set of activities to improve children's health and well-being, which is repaid over time based on the value to the issuer predicted by those improvements.
- The greater the health risk that children face in the beginning, the larger the payoffs will be, so this approach intrinsically advances long-term equity.

Equity Increment Financing: The Flow

Project Developed

- Municipality or other entity develops an eligible portfolio of projects.

Terms Set

- Expected returns are estimated based on the projects' expected impact on short-term outcomes, using a rate card.

Bond Sold

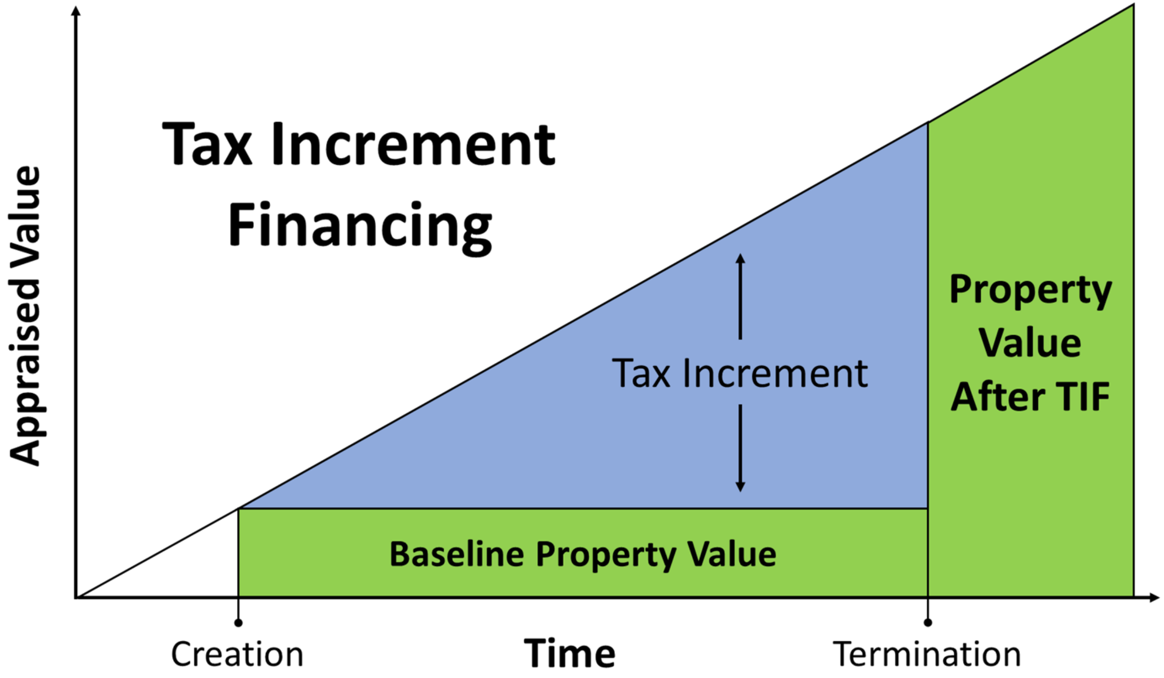
- Bond terms are set based on the riskiness, estimated returns, and bond market forces, and sold to buyers.

Debt Repaid

- The bond is repaid over 20-30 year, with the repayment amount based on the short-term outcomes achieved.

Equity Increment Financing: Fundamental Components

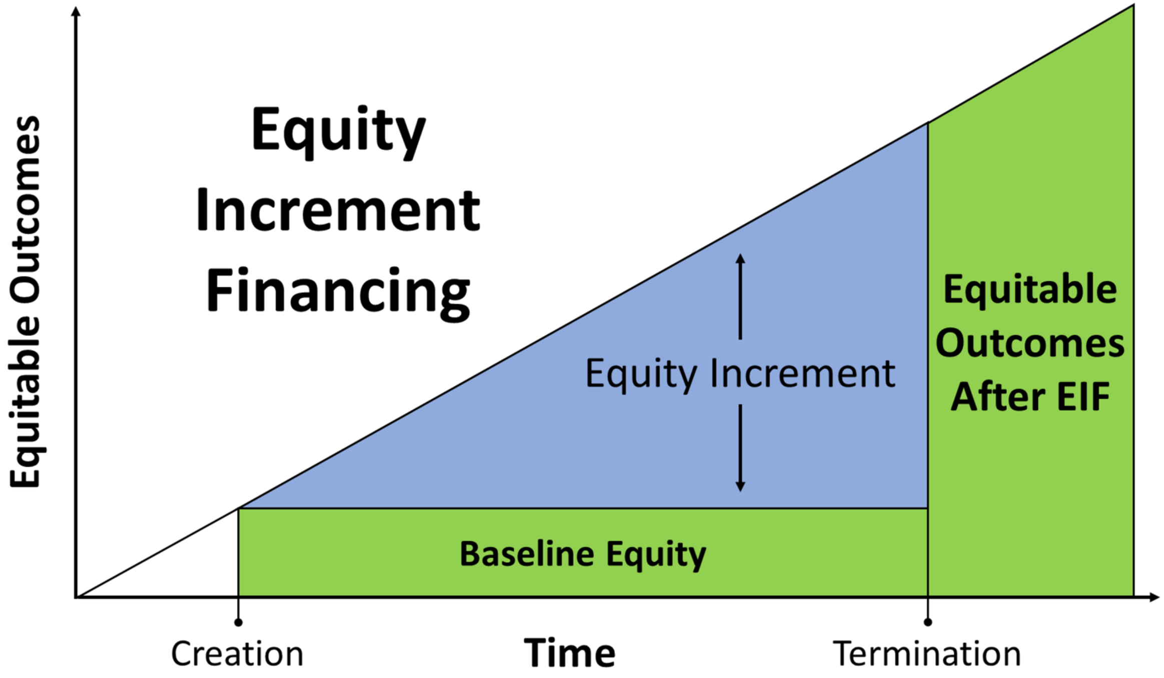
1. Identify redevelopment area and perform "but for" analysis
2. Create district improvement plan and launch TIF district
3. Redevelopment begins
4. Repay bond, fund expenditures, or reimburse developers
5. TIF expires and then full taxes received



Source: Planning Tank, *Tax Increment Financing (TIF)* | *Public Financing* | *Types of TIF*

Equity Increment Financing: Fundamental Components

1. Identify target population and perform "but for" analysis
2. Create intervention plan and launch EIF
3. Interventions begin
4. Measure outcomes
5. Repay bond, fund expenditures, or reimburse other funders
6. EIF expires and then full benefits received



Equity Increment Financing: Rate Card Approach

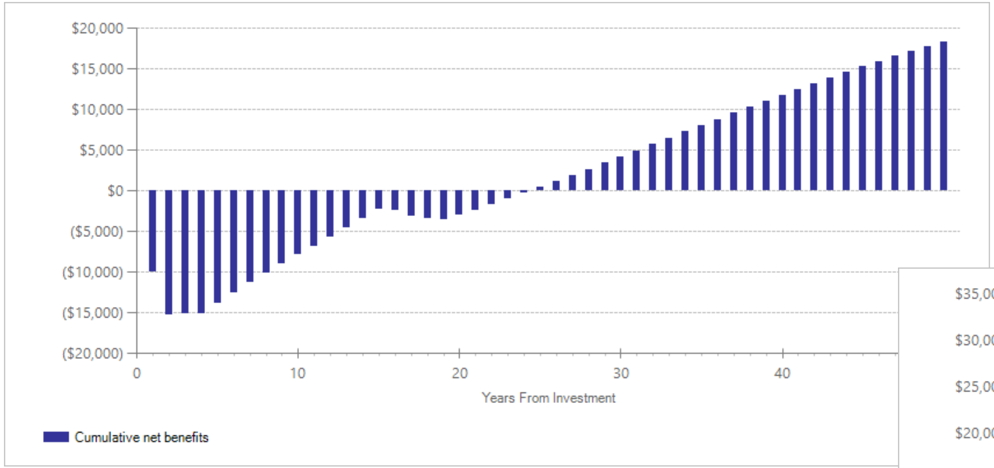
1. Government identifies outcomes, set rates, and issues rate card
2. Service providers apply
3. Government chooses service providers
4. Service providers initiative intervention(s)
5. Government pays for successful outcomes

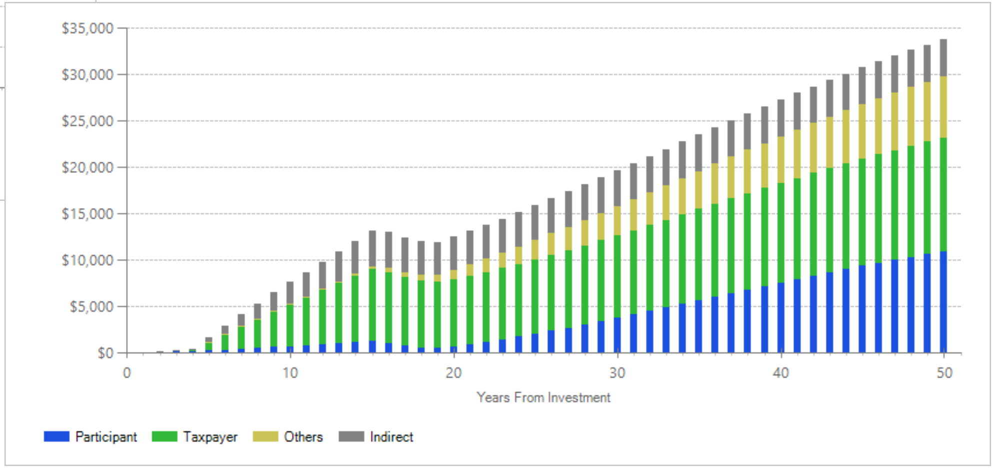
Connecticut's First Home Visiting Outcomes Rate Card (2018)

Metric	Definition	Low-risk family bonus payment	High-risk family bonus payment
Safe children	At the time of measurement, there are no substantiated cases of maltreatment (other than any reported by provider staff) and no incidents of injury- or ingestion-related visits to the emergency room.	$90	$115
Caregiver education and employment	At the time of measurement, the caregiver is employed, enrolled in education or training, or has recently graduated from an education or training program.	$180	$225
Full-term birth	For families enrolled prenatally before 28 weeks' gestation, the child is born at 37 weeks' gestation or later.	$135	$170

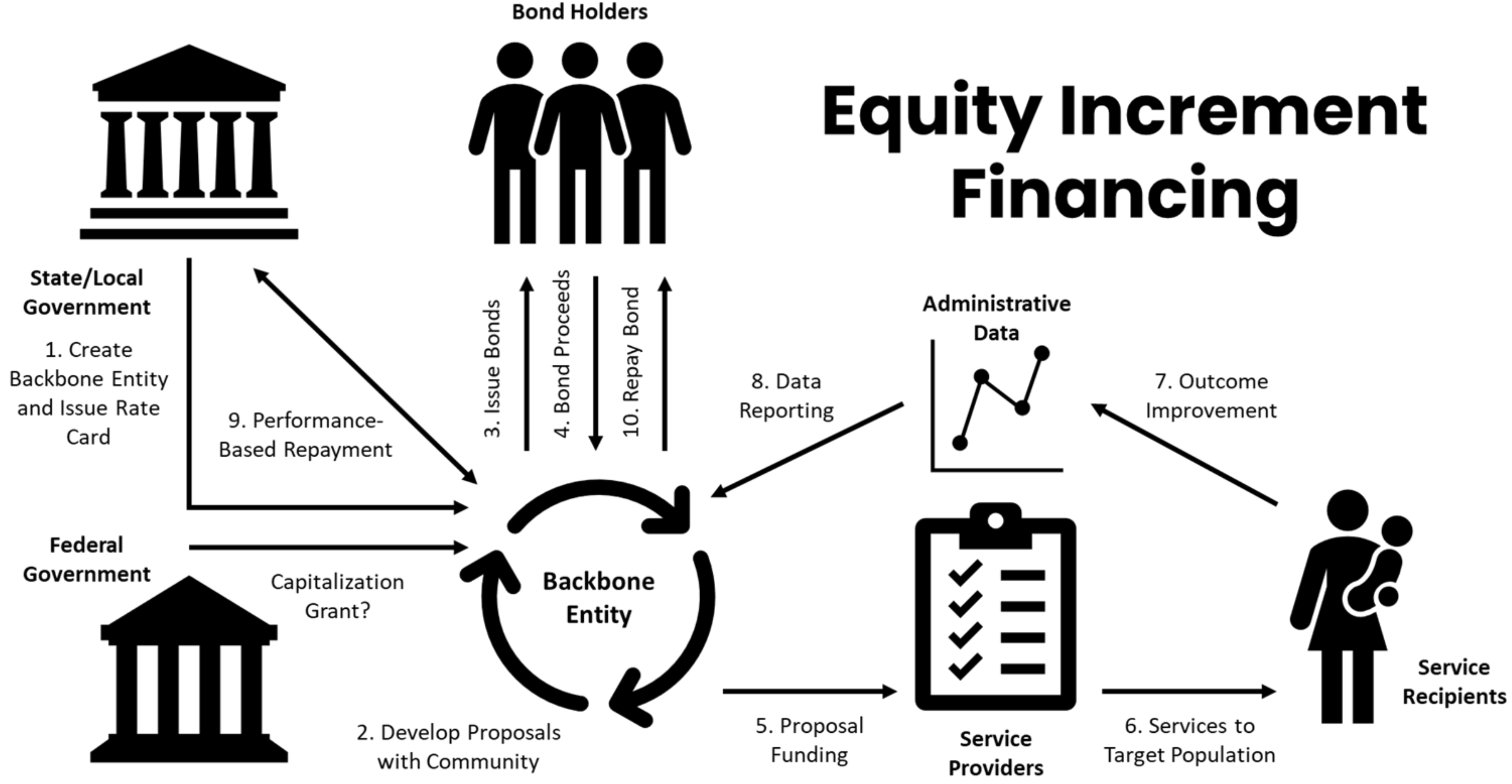
Source: *A Whole New Menu, Outcome Rate Cards in Practice* by David Wilkinson

Equity Increment Financing: Child-Parent Center Example





Source: https://www.wsipp.wa.gov/BenefitCost/Program/995



Note: Based upon Environmental Protection Agency Revolving Fund Diagram

Equity Increment Financing: The Backbone Entity

- Tasked with managing all aspects of program development and financing
- Could be a created new or contracted to a municipality, CDFI, non-profit
- Governed by an oversight board with members from executive and legislative branches, community, and other stakeholder groups
- Staffed with experts on child policy, program evaluation, economics, statistics, finance, collective impact and other key functional areas
- Puts together projects that meet certain criteria:
  - Meets “but for” standard with target population
  - Approaches most likely to achieve sufficient performance on rate card
  - Community power and wealth building requirements

Equity Increment Financing: Backbone Models

The Children's Trust

- Through a state law, Miami-Dade voters approved the creation of The Children's Trust in September 2002
- Funded by a levy up to 50 cents per $1,000 of property tax value
- Governed by an independent 33-member board, representing both the public and private sectors
- Expects to spend more than $170 million during 2022-23 across various areas, including education, health, parenting, citizen engagement, and advocacy

Delaware Sustainable Energy Utility

- Created in 2007 to develop and coordinate programs for energy end-users in Delaware and promote sustainable use of energy
- Authority to raise tax exempt bonds for Energy Saving Performance Contracts (ESPC) that state agencies and school districts can utilize
- ESPC is a budget neutral approach to pay for facility upgrades with future energy savings — without tapping into capital budgets

Equity Increment Financing: How is it Different?

Compared to Current Public Spending Approaches

- Long-term perspective focused on improving outcomes
- Embeds building community power, wealth and equity

Compared to Tax Increment Financing

- Focuses on a cohort of people rather than a geographic area
- Repaid based on changes in outcomes and spending on people rather than property

Compared to Pay for Success or Social Impact Bonds

- Longer time horizon for capturing outcomes and value more tied to equity
- Built on existing finance structures and markets, so lower transaction costs
- Intended to spin off multiple projects and interventions

Equity Increment Financing: What Is It and What Is It Not?

What is it?

- A new tool to advance strategies that promote long-term child health and well-being
- An opportunity to envision and implement more substantial approaches to improve well-being
- A faster way to inject resources into interventions that improve outcomes and reduce public costs
- A structure to assess whether public dollars are having an impact

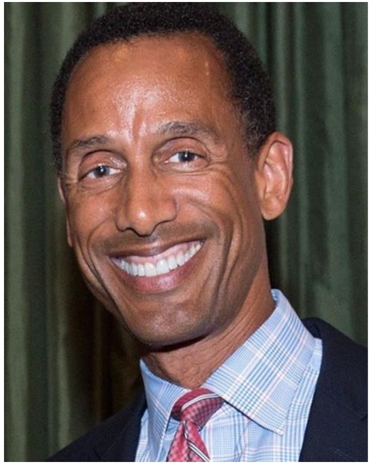
What is it not?

- A replacement for existing public spending on health, education, and other issue areas
- Privatization of public services
- Private equity control over public resources
- Unchecked spending on ineffective programs
- Changing existing legislative and executive functions in government

Respondent Panel

Navjeet K. Bal, Managing Director and General Counsel, Social Finance

Richard J. “Rick” Geisenberger, Secretary of Finance, State of Delaware



Otho E. Kerr III, Director, Strategic Partnerships and Community Impact Investing, Federal Reserve Bank of New York

Appendix

Key Questions

- What would make EIF bonds most attractive to buyers/investors?
- What resources do rating agencies need to evaluate EIFs?
- What data and other types systems need to be in place for scaling?
- What components would make EIFs most relevant to municipalities?
- What role could philanthropic and social impact dollars play in catalyzing EIFs?
- What roles could the federal government play to facilitate EIF bonds?
- What other examples exist currently that relate to EIF bonds?

Equity Increment Financing: Financing Models

Connecticut Rate Card

- Focused on home visiting programs, which serve at-risk pregnant women and mothers of young children
- Capped each provider's bonus payments at 3% of its total contract value
- The rate card paid providers for:
  - No cases of child maltreatment
  - Caregiver employment/education
  - Full-term births
- The state has since released numerous rate cards with various tweaks

DC Water Environmental Impact Bond

- Washington, DC sewers dumping ~2.5 billion gallons of combined sewer water annually into 3 rivers
- In 2016, project built green infrastructure to manage runoff
- Financed by 30-year $25 million tax-exempt municipal bond (Goldman Sachs and Calvert Foundation) with repayment based on reductions in stormwater runoff
- In spring 2021, DC Water made mandatory tender and full repayment

Equity Increment Financing: Comparison of Mechanisms

Component	Tax Increment Financing	Pay for Success	Equity Increment Financing
Funds:	Finances mostly physical capital	Finances social programs	Finance any set of interventions
Repayment Basis:	Repayment based on property tax and sales tax increases for geographic area	Repayment based on multiple outcomes for individuals served	Repayment based on multiple benefit streams across individuals served
Returns:	Returns based on revenue above benchmark	Returns based on upfront negotiation and outcomes	Returns determined from short-term outcomes and rate card
Repayment Period:	20-30 year repayment period	~5 year repayment period	20-30 year repayment period

Equity Increment Financing: Definitions

- **Tax Increment Financing:** TIF allows local governments to **invest** in public infrastructure and other improvements **up-front**. Local governments can then **pay later** for those investments. They can do so **by capturing the future anticipated increase in tax revenues** generated by the project. This financing approach is possible when a new development is of a **sufficiently large scale, and when its completion** is expected to result in a **sufficiently large increase in the value** of surrounding real estate such that the resulting incremental local tax revenues generated by the new project can support a bond issuance. (Source: World Bank)

- **Rate Card:** An outcomes rate card is a **menu of outcomes** that defines **how much a government is willing to pay** each time that a **positive outcome is achieved**. Outcomes-based contracts require **clearly stated policy goals**, a **measurement plan** to assess progress on those goals, and **high quality implementation** and **data tracking**. (Source: Social Finance)