ISSUE BRIEF 8

Outcomes-Based Contracting

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Outcomes-based contracts bolster Pay for Success (PFS) projects. In this brief, we introduce outcomes-based contracting and methods of incorporating outcomes-based mechanisms into existing contracts, provide examples of outcomes-based contracting, and unpack situations where these tools may not work best.

About This Issue Brief Series

This issue brief is the first in a 10-part series written for government officials interested in learning how to use Pay for Success tools and principles.

The series summarizes best practices and lessons learned at Social Finance from a decade of designing, launching, and managing Pay for Success projects. It includes guidance on each step of the process, from deciding whether Pay for Success is a good fit to actively managing a project post-launch.

Access the complete issue brief series here.

Contracting For Outcomes, Not Services

Outcomes-based contracts are agreements that focus on the specific results or outcomes that a service provider will deliver, rather than just the inputs or activities that will be undertaken. The service provider is paid based on the achievement of these outcomes and when blended with standard fee-for-service contracts, these contingent payments, which are described more fully later in this brief, can encourage more than just the completion of tasks or delivery of services.

The goal of outcome-based contracting, sometimes called pay-for-success contracting, is to align the incentives of the service provider and the government, and to focus on the achievement of specific policy goals or outcomes—e.g., increased time in community vs. time in custody—instead of solely the completion of tasks—e.g., enrollment. This can lead to better outcomes for both parties, as the service provider is incentivized to focus on delivering the best possible results, while government receives a more tailored and effective solution. This approach to contracting has garnered global attention across various sectors, from social services to government initiatives, offering new avenues to drive efficiency, incentivize impactful performance, and address pressing issues with creative solutions.

Outcomes-Based Contracting Overview

Organizations considering outcomes-based contracting typically consider several essential variables:

Focus and Objective	This type of contract focuses on achieving specific outcomes or results. The payment to the service provider is contingent upon meeting pre-defined performance metrics or achieving certain goals. The emphasis is on the results and impact rather than the specific activities or inputs used to achieve those outcomes.
Parties Involved	Typically involves two parties, the client or the organization funding the service (e.g., government agency), and the service provider (e.g., a non-profit organization or a private company). The provider is paid based on the successful achievement of outcomes.
Funding Mechanism	Service provider funding is usually provided upfront or periodically during the contract term. This upfront funding can come directly from the funder (e.g., government agency), from outside sources (e.g., impact investors or philanthropy), or from the service provider's own balance sheet. See below for repayment implications.
Repayment Risk Allocation	Payment is linked to the achievement of outcomes. If the agreed-upon outcomes are not met, the outcomes funder may make reduced or no payments. As such, project partners must understand, and structure appropriately, the risk of repayment. Typically, the different funding sources of the upfront costs (investors, philanthropy, provider) bear the risk of repayment. Depending on the level of contingency (see below), these sources may not cover the full cost of service delivery.

Incorporating Outcomes-Based Principles Into Existing Contracts

In outcomes-based contracting, a dynamic spectrum of payment strategies exists to align incentives, manage risks, and ensure the successful attainment of predefined goals. Nestled within this spectrum is the concept of contingency payments, where some portion of service provider's compensation, up to 100%, is contingent upon achieving specific outcomes or results as outlined in the contract. In other words, the provider only receives payment if the predefined outcomes are successfully realized. This type of fee structure is designed to align the interests of the service provider with the goals of the client or customer. Contingent payment structures are often used in situations where the outcomes are measurable and directly tied to the success of the project or service. For this issue brief, two example mechanisms that incorporate a contingency structure are bonus payments and outcomes rate cards.

Outcomes-Based Contracting Example: Social Impact Bond

One PFS tool that relies heavily on outcomes-based contracting is the Social Impact Bond (SIB). A SIB is a public-private partnerships where outside funders, like mission-driven investors and philanthropy, provide upfront capital to scale quality service providers and government partners repay those investors based on agreed-upon outcomes. In 2022, Social Finance launched a SIB to expand access to quality prenatal and postnatal care to 120 first-time, Medicaid-eligible mothers. Learn more.

BONUS PAYMENTS

Bonus payments are incentive mechanisms introduced to reward exceptional performance. In a bonus payment structure, the provider typically receives a base fee-for-service for standard services, and then an additional bonus payment if they surpass certain performance thresholds. The bonus payment is intended to reward exceptional performance and provide an extra incentive for the provider to excel in their delivery. Austin Public Health integrates a bonus payment approach into its rapid rehousing program, which funds homelessness service providers. The agency developed a scorecard that measures and scores impact to Austin residents served from the time they are referred to the program, through obtaining housing, and ultimately finding a permanent place to call home. Service providers earn bonus payments based on scorecard performance.

OUTCOMES RATE CARDS

Outcomes rate cards (ORCs) are contracting and procurement tools that enable governments to select set of metrics for which service providers can earn a payment, either contingent, bonus or both, for the achievement of each metric. It provides a standardized list of outcomes, along with their corresponding prices or rates that service providers can be compensated for achieving. The purpose of an ORC is to establish transparency and consistency in pricing for various outcomes, making it easier to negotiate and structure outcome-based contracts. The Connecticut Office of Early Childhood, a state agency that supports children from birth to grade school in Connecticut, uses an ORC to identify payment-linked metrics such as key population enrollment; prenatal enrollment; caregiver education, training, or employment; and prenatal and postpartum care. An outcomes rate card can also vary in contingency—at 100%, it will be closer to a SIB, and at say, 10%, it will be closer to a bonus payment.

Outcomes-Based Contracting Might Not Always Fit

While outcomes-based contracting can be an effective and innovative approach in many situations, there are circumstances where its use may not be suitable or advisable. Below are some examples of instances in which trying to build a relational outcomes-based contract may not be beneficial:

- Unmeasurable or uncontrollable outcomes: If outcomes are difficult to define clearly or measure objectively, establishing a reliable contract based on them may be challenging. Lack of clarity on outcomes can lead to payment disputes and difficulties. Similarly, if the service provider has limited control over the factors influencing the outcomes, using outcomes-based contracting may not be fair or feasible.

- Lack of reliable data and metrics: Outcomes-based contracts may require robust data and metrics to measure performance accurately. Often, multiple data sets across government agencies and providers are needed on a timely basis, and this may require data sharing agreements. If such data is unavailable or unreliable, it may be challenging to assess outcomes and ensure fair payments.

- Limited provider capacity or short project timelines: Outcomes-based contracting may require service providers to invest more resources in delivering outcomes. If providers lack the capacity or expertise to meet outcome targets, it could lead to failure or compromised service delivery. Outcomes-based contracts are typically more suitable for longer-term initiatives where outcomes can be achieved over time.

- High transaction costs: If the administrative costs associated with designing, monitoring, and evaluating an outcomes-based contract outweigh the potential benefits, it may not be cost-effective to use this approach.

- Inflexible funding sources: Outcomes-based contracting often requires flexible funding sources that can be tied to specific results. If funding sources are rigid or limited, it may not be feasible to implement this type of contract. For example, appropriation laws typically make funds available for one to two years even though projects that focus on outcomes may span multiple years. This "appropriations risk" is that a legislature will not appropriate funding for future payment of obligations under an outcomes-based contract. Appendix A: Legal Mechanisms to Secure Outcomes Funding identifies mechanisms that have been sued to successfully overcome inflexible funding.

Ultimately, the decision to use outcomes-based contracting should be based on a careful assessment of project characteristics, risks, and the availability of resources and data. Traditional contracting methods or alternative payment structures might be more appropriate in certain situations to meet the needs of the people and communities a given project intends to serve.

Relational Contracting

Relational contracting highlights the importance of mutual trust in longer-term, joint ventures that foster strong communication and cooperation among parties, such as in complex PFS projects. Relational contracts may contain relationship-building elements such as shared vision statements or guiding principles that can help keep parties' expectations and interests aligned.

The act of documenting first principles creates shared project values and goals that can be used to constructively resolve disputes that may arise. And keeping first principles front and center helps align partners around true project goals and eases navigation of challenging tradeoffs.

Appendix: Legal Mechanisms to Secure Outcomes Funding

The legal mechanisms outlined below allow payors to follow their local rules and budget mandates while still allowing them to participate in long-term PFS projects.

Funding Mechanism	Overview	Example
Full Faith and Credit	The equivalent to a General Obligation Bond, language is included in enabling legislation that PFS outcome payment obligations have the full faith and credit of the jurisdiction. Requires appropriate legislative approval and may require voter approval.	A Massachusetts legislative act created the Social Innovation Financing Trust Fund [1] to back PFS contracts with the "Full Faith and Credit" of the Commonwealth, up to $50M in PFS payments. To date, Massachusetts is the only jurisdiction to have done this.
Escrow Account Held by Third Party	An escrow is established and held by a third party to manage government deposits should outcomes be achieved in accordance with the PFS agreement. How funds are handled if outcomes are not achieved is dependent on the specific PFS contract, but generally, any funds held in escrow at the end of the contract are returned to the jurisdiction.	In two PFS projects in South Carolina [2] and Connecticut [3], the states make deposits into an escrow account in either an annual amount based on the next year's maximum outcome payment obligation, or in a single deposit equal to the maximum outcome payment.
Non-Lapsing PFS Fund	An account, also called a "sinking fund," created for the purpose of PFS outcome payments. Funds are deposited at project onset or periodically to meet future obligations. Unspent funds, if any, do not revert to the General Fund until the project terminates.	The New York Department of Veteran Services and the City of Boston created non-lapsing funds, protecting funds set aside for the Veterans CARE project from reverting to the General Fund at the end of the year. [4]
Annual or Biannual Line Item Appropriations	Outcome payment funds are appropriated through annual or biannual budgets. Projects must be structured to terminate in the event that sufficient funds are not appropriated.	New York State annually appropriates maximum PFS contract obligations to a line item. Unspent funds are reverted at the end of each fiscal year and must be re-appropriated in the next budget cycle.

1. Massachusetts General Laws, 2012.
2. Social Finance, 2016.
3. Social Finance, 2016.
4. Social Finance, 2018.

Acknowledgements

This issue brief series was made possible with funding from the Robert Wood Johnson Foundation (RWJF) as part of their work to promote cross-sector alignment to better address the goals and needs of people and communities. The views expressed here do not necessarily reflect the views of the Foundation. To learn more about RWJF's work in cross-sector alignment, visit alignforhealth.org.

About Social Finance

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Updated June 2024.