In August 2012, Goldman Sachs Bank’s Urban Investment Group (UIG) announced the first social impact bond (SIB) in the United States, a $9.6 million loan it would make to support the delivery of therapeutic services to 16- to 18-year-olds incarcerated on Rikers Island.\(^1\) The loan will be repaid based on the actual and projected cost savings realized by the New York City Department of Correction as a result of the expected decrease in recidivism. This unique public-private partnership between the City of New York, MDRC, the Osborne Association, Bloomberg Philanthropies, and Goldman Sachs leverages high-quality nonprofit capacity, private-sector capital, and philanthropic support to address a pressing community challenge.

Financing the provision of therapeutic services to inmates at Rikers Island represented a unique opportunity to fulfill UIG’s commitment to double bottom line investing by making a real difference in the lives of the adolescents imprisoned at Rikers Island while earning a modest return in line with traditional community development financing products. In addition to the social and financial returns associated with this transaction, UIG also saw it as an opportunity for Goldman Sachs to make a significant contribution to the development of a new financial instrument that has the potential to transform the way service providers, governments, and financial institutions collaborate to address pressing social issues with evidence-based interventions.

Several trends have made SIBs a topic of much interest. Local government budgets are increasingly strained, leaving governments unable or unwilling to finance preventative interventions. The social service sector is under increasing pressure to focus on evidence-based interventions that work. At the same time, nonprofit providers are looking for reliable sources of long-term funding. In this context, the Rikers Island transaction represents a first step in developing the potential of the SIB to harness these trends.

**Transaction Structure**

The Goldman Sachs loan is structured as a $9.6 million multiple-draw term loan to MDRC, an experienced intermediary known for bringing together public and private funders to test new policy ideas. MDRC will use the proceeds of the loan to provide funding to the service provider, the Osborne Association, which has extensive experience in providing services to incarcerated youth. MDRC, through a contract with New York City, will oversee the

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\(^1\) The Rikers Island transaction is technically not a bond; it is a loan. But the expression *social impact bond* is in such regular use that for ease of recognition, we refer to the transaction as a social impact bond.
day-to-day implementation of the project and is responsible for any payments to Goldman Sachs. The Vera Institute of Justice, an independent, nonpartisan, not-for-profit center for justice policy, will serve as the evaluator of the program and will evaluate the extent to which the program has reduced the rate of recidivism among Rikers Island inmates participating in the program. Based on the results of the evaluation (at twelve- and twenty-four-month postrelease intervals), New York City will provide success payments to MDRC based on the actual and projected cost savings from the reduced recidivism rate, according to the payment schedule shown in Figure 1. MDRC then repays the Goldman Sachs loan from the New York City success payments.

The transaction benefits from a guarantee provided by Bloomberg Philanthropies. The foundation provided a $7.2 million grant to MDRC to guarantee a portion of the loan, thus reducing Goldman Sachs’ risk. However, the grant is paid over time in such a way that at any given time, there is Goldman Sachs capital at risk in the transaction. Any unused portion of the guarantee fund will remain with MDRC to support future efforts of this sort. Figure 2 depicts the flow of funds among the parties.

**Risks and Mitigants**

**Impact Risk**

Because the financial outcomes of an SIB transaction depend directly on successfully achieving social outcomes, evaluating the proposed intervention and the service providers implementing it is an important part of the due diligence process. Goldman Sachs’ due diligence included a review of the capabilities of both the Osborne Association and MDRC, and a review of the efficacy of the program to be provided at Rikers Island by the Osborne Association. The deep experience, expertise, and accomplishments of the partners in the transaction, MDRC and Osborne, grounded Goldman Sachs’ confidence that the social outcomes would be achieved. In addition, the review of the efficacy of the proposed
FP will make a $7.2mm grant, funded annually over 4 years, to MDRC.

GS will make a $9.6mm senior multiple draw term loan to MDRC paid out quarterly over 4 years.

MDRC will provide funding of $9.6mm paid out over 4 years to Osborne, in order to support the direct costs associated with the program.

Vera will measure the impact of the program at 12 and 24 month intervals post release.

NYC will realize a stream of savings from the decrease in recidivism and will make up to two Success Payments to MDRC for a maximum of $11.7mm. These payments will be based on the threshold decreases in recidivism as measured by Vera.

After 3 years, MDRC will repay GS $2.4mm from the Success Payments or from the guarantee fund. After 5 years, MDRC will repay GS the Success Payments and, if necessary, an amount from the guarantee fund needed to repay the GS principal.
intervention uncovered an extensive body of research that shows that the type of therapy that would be provided is effective in significantly reducing recidivism rates.\footnote{See, for example, Mark W. Lipsey, Nana A. Landenberger, and Sandra J. Wilson, “Effects of Cognitive-Behavioral Programs for Criminal Offenders,” \textit{Campbell Systematic Reviews} (6) (2007), which is a meta-analysis of fifty-eight research studies, available at www.campbellcollaboration.org/lib/download/143/ .}

\textbf{Execution Risk}

The SIB model relies on a complex, interrelated set of contracts. For example, MDRC juggled a loan agreement with Goldman Sachs, a grant agreement with Bloomberg Philanthropies, a contract with New York City, and a contract with the Osborne Association. The entirety of the transaction consists of a complex set of contracts and agreements that, if properly executed, aligns the participants’ incentives in a mutual agreement that serves the needs of all parties. Managing the multiple contracts required extensive diligence and review by legal counsel on all sides.

\textbf{Performance Risk}

Another consequence of the multiparty nature of the SIB model is that the success of the transaction depends on all parties fulfilling their obligations throughout the duration of the various contracts. In the negotiations for the Rikers Island transaction, a number of contingencies were imagined—for example, the risk that the city would not appropriate funds for the program, or that the service providers would not implement the required intervention—and such risks were mitigated with appropriate contractual protections. Ultimately, however, the strength of the transaction did not come from the detailed contracts but from the quality, professionalism, and strong track records of all the parties to the transaction.

\textbf{Going Forward}

The Rikers Island transaction came about because a remarkable confluence of factors made it a good candidate for the first SIB in the United States. The transaction included strong partners on all sides—New York City, MDRC, the Osborne Association, the Vera Institute of Justice, Bloomberg Philanthropies, and Goldman Sachs—and demonstrated that such transactions could be structured in a way that would benefit all parties. The efficacy of the intervention services is well documented and researched, and the savings expected as a result of successful intervention are quantifiable. While this structure worked in this transaction, new models and new structures will no doubt emerge as more SIBs are completed.

A number of other SIB transactions are already underway that will apply this approach to other interventions including early childhood education, job placement and employment services. We expect that future transactions will explore different levels of risk sharing between the investor, service provider, intermediary, and government (in the Rikers Island transaction, only Goldman Sachs and Bloomberg Philanthropies had some downside risk). We also expect that rapid learning will take place as different structures and models are developed and implemented, and that the terms and agreements in SIB transactions will become
standardized over time. The role of impact evaluations will be a key area of focus, particularly as these efforts begin to increase in scale.

While Goldman Sachs is cautiously optimistic that the SIB as a financial instrument can be replicated and brought to a larger scale, we are also very aware that more examples of successful transactions will be needed before the SIB has fully realized its much-discussed potential. We look forward to participating in the ongoing evolution of the SIB and helping this new financial instrument reach its full potential.

John Olson recently joined Goldman Sachs to lead Goldman Sachs Bank USA’s Community Reinvestment Act (CRA) compliance program. Prior to joining Goldman Sachs, he was a manager in the Community Development Department at the Federal Reserve Bank of San Francisco.

Andrea Phillips, vice president in the Goldman Sachs Urban Investment Group, leads deal teams with a focus on social innovation and economic development financing as well as access to capital for small businesses as part of the Goldman Sachs 10,000 Small Businesses initiative. She led the investment in the Rikers Island social impact bond. Prior to joining Goldman Sachs, she was president of Seedco Financial.

Goldman Sachs’ Urban Investment Group (UIG), established in 2001, deploys the firm’s capital by making investments and loans that benefit urban communities. Through its comprehensive community development platform, UIG has committed more than $2.8 billion to catalyze the revitalization of underserved neighborhoods, financing nearly 13,000 housing units for low-, moderate- and middle-income families, 1.9 million square feet of commercial and retail space, and more than 1.3 million square feet of facilities serving a variety of community needs, and providing capital to mission-driven intermediaries that provide financing to small businesses as part of the Goldman Sachs 10,000 Small Businesses initiative. UIG is also the business unit responsible for fulfilling the Community Reinvestment Act (CRA) obligations of Goldman Sachs Bank USA.