

FINANCING PROMISING EVIDENCE-BASED PROGRAMS

EARLY LESSONS FROM
THE NEW YORK CITY
SOCIAL IMPACT BOND

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Overview

A Social Impact Bond (SIB) relies on initial financing from private investors to produce outcomes governments value. This report describes the first operational SIB in the United States and the program financed by it, the Adolescent Behavioral Learning Experience (ABLE). ABLE aims to equip adolescents ages 16 to 18 incarcerated in the New York City jail system with the social and emotional skills to help them make better life choices when they leave jail, yielding financial savings to city government by reducing readmissions to Rikers Island. During their time on Rikers adolescents participate in Moral Reconciliation Therapy, a cognitive behavioral program designed to help offenders reevaluate their choices and enhance their decision-making abilities. Those who leave Rikers before completing the program have the opportunity to resume participation afterward when they return to their communities.

Bloomberg Philanthropies and the Urban Investment Group of Goldman Sachs Bank USA are providing the funding for ABLE: Goldman Sachs provided a loan to pay the cost of operating the program, and Bloomberg Philanthropies guaranteed part of the loan amount in the event the program is not successful. If the program is successful and meets its benchmarks, the resulting reductions in future incarceration days should save the City of New York money, and the city will use a part of those savings to pay back the investment. If the program fails to meet the required benchmarks, the city will not achieve any savings and will not pay back the investment. MDRC serves as the intermediary managing the deal, and is responsible for designing the intervention, negotiating and coordinating the financial terms, and overseeing the operations of the ABLE program. The Osborne Association and Friends of Island Academy are the service providers delivering the program in Rikers Island jail.

The New York City SIB is the first public-private partnership following a Social Impact Bond model to involve a large financial institution. It is also the largest implementation of a Moral Reconciliation Therapy program to date. This report attempts to illustrate the merits and challenges of each, and touches on some important lessons that have emerged from these early stages:

- A committed government partner is especially important to a SIB arrangement.
- Investors will have more confidence in a SIB if small differences in program performance do not cause sharp distinctions between gaining a return on investment and experiencing a loss. They will also have more confidence in SIBs that incorporate early performance indicators, and in those whose transaction costs are lower.
- Holding repayment until clear evidence that savings are in fact being achieved increases the government partner's confidence in the effectiveness of the program.
- Spreading out repayment to align with the value produced by the program increases the government partner's ability to pay.

Preface

Governments often lack the financial resources to try and expand promising social services. Social Impact Bonds (SIBs) have the potential to overcome that problem by attracting private investment as public risk capital, thereby revealing what does and does not work while improving government effectiveness and the lives of individuals.

In a SIB, private investors finance the cost of operating a promising or innovative social program with the potential to save the government money or achieve some other valued goal — for example, increasing citizens’ productive capacity. If the intervention achieves its desired outcomes, the government repays the initial investment plus a return.

The SIB concept is still in its earliest stages. Although the first SIB was introduced in the United Kingdom in 2010, to date the only operational SIB in the United States is the project described in this report, the New York City SIB, launched in 2012 along with the program financed by it, the Adolescent Behavioral Learning Experience. With financial support from the Urban Investment Group of Goldman Sachs Bank USA and Bloomberg Philanthropies, MDRC partnered with the City of New York and two nonprofit organizations to provide a large-scale intervention designed to reduce recidivism among young people in custody at Rikers Island jail.

For too many young people, the first time they enter the criminal justice system will not be the last. In New York City, nearly half of all adolescents incarcerated in Rikers Island jail will return within one year of being discharged. Incarceration interrupts education, weakens employment prospects, and puts additional strain on vulnerable young people, families, and communities. It is also costly: the City of New York budgets over \$1 billion each year to operate its jails. Reducing recidivism among young people would benefit society and government.

If an independent evaluator determines that the intervention (a cognitive behavioral therapy program) reduces recidivism by at least 10 percent, the project will be deemed a success and the Department of Correction will pay back the investors for the cost of operating the program. If that happens, adolescents will have spent less time in jail and the city will have saved a substantial amount of money over and above the amount of the investment.

This project demonstrates that it is feasible to use private capital to finance social programs. In the coming years the concept will be adapted to a number of other policy areas. Early projects may be built around government savings and have high transaction costs, but over time as governments get better at estimating their willingness to pay, transaction costs should decrease, and SIB arrangements could become more commonplace. To get there from here, how-

ever, governments, private investors, philanthropies, and nonprofit service providers will face many complex issues. It will be essential that the earliest deals be carefully constructed with ample due diligence, a pilot period to identify and resolve challenges, and sound research designs to ensure that reliable learning results.

Gordon L. Berlin
President

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MDRC appreciates the strong partnerships and continued collaboration of the New York City Mayor's Office, the Department of Correction, East River Academy, the Vera Institute of Justice, the Osborne Association, and Friends of Island Academy. We are particularly grateful to Deputy Mayor for Health and Human Services Linda Gibbs, Correction Commissioner Dora Schriro, Erik Berliner, Jim Parsons, Elizabeth Gaynes, and Christine Pahigan, all of whom made time to share their perspectives and experiences with us.

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The Authors

Executive Summary

Lack of money has long kept promising preventive programs from expanding. Existing government-funded programs are furthermore subject to budgetary cutbacks or complete loss of funding. Moreover, preventive programs traditionally offer no accountability for success or failure. This leaves government entities in a bind where if they invest their limited funding in preventive programs that turn out to be ineffective, they end up paying for both the ineffective program and the services the program was intended to prevent.

Social Impact Bonds (SIBs) aim to combat chronic underinvestment in preventive programs while promoting increased accountability. This report details the structure of the New York City SIB and the program that it finances, the Adolescent Behavioral Learning Experience (ABLE). Specifically, readers can expect to find answers to the following questions: How did this project (SIB and ABLE) emerge as a priority in New York City? What exactly is a SIB? How was this SIB structured? What challenges arose in negotiating the financing arrangement? What are the main components of ABLE and what is it trying to accomplish? What have been the main accomplishments and challenges in designing and implementing the program? Finally, what has been learned from the project and how can this knowledge be applied to similar initiatives that pay for success?

Project Background

In January 2010, Mayor Michael Bloomberg announced a new effort to improve the lives of young black and Latino men, who experience much higher rates of poverty, unemployment, and homicide than their white and Asian peers.¹ Agencies and thought leaders were charged with finding ways to make a difference in the lives of these young men, which led to the creation of the Young Men's Initiative (YMI). The YMI focuses on programs and policies designed to improve outcomes for this population in education, health, employment, and the criminal justice system.

Given that approximately 20 percent of New York City's black and Latino young men fell within its target age range of 16 to 24,² the YMI promised to be a large undertaking requiring a significant amount of funding. During the planning process for the YMI, agencies had identified a number of bold ideas that exceeded the total funding available for the YMI initia-

¹David Banks and Ana Oliveira, *Young Men's Initiative: Report to the Mayor from the Chairs* (New York: New York City Office of the Mayor, 2011).

²New York City Department of City Planning, *Total Population by Age, Sex, and Mutually Exclusive Race, 2010* (New York: New York City Department of City Planning, 2010).

tive.³ City leaders then learned about a cutting-edge financing strategy being tried in the United Kingdom called a Social Impact Bond.

A SIB is a form of “Pay-for-Success” financing in which public and private partners collaborate to provide initial private investment support for a public program. Pay-for-Success contracts base payment to providers on outcomes (for example, achieving a goal related to community job placement or retention) rather than just costs. The concept makes investment in innovation possible during a period of constrained government funding, because it lessens the risk that taxpayers will pay for ineffective programs. Bloomberg Philanthropies’ government innovation team was exploring the SIB concept and was interested in bringing it to the United States. The team, focused on spreading proven and promising ideas among cities, saw great potential in this innovative financing model. Bloomberg Philanthropies was also committed to the YMI, and joined the city in efforts to find a YMI effort that could benefit from a SIB.

The Office of the Deputy Mayor for Health and Human Services and the government innovation team at Bloomberg Philanthropies reviewed over 40 projects being considered for the YMI portfolio to determine which fit the SIB criteria. Specifically, they looked for:

- Services that were largely funded by the city (as opposed to the state or the federal government), where there could be enough city savings generated to pay for a successful program
- Programs that focused on prevention rather than core services
- Programs with evidence of success
- Programs with measurable outcomes
- Programs that would result in government savings large enough to sustain the program beyond the funder’s investment

The New York City Department of Correction (DOC) was interested in implementing a large-scale program for adolescents incarcerated in Rikers Island jail (Rikers), with the goal of reducing future recidivism (that is, the rate at which they return to jail in the future) and better preparing them for release during their stay. Adolescents incarcerated on Rikers are 91 percent black and Latino and have a 47 percent chance of returning to jail within one year, making it a

³The mayor announced a total funding commitment of \$127 million to support YMI work, including \$30 million from the Open Society Foundation, \$30 million from Bloomberg Philanthropies, and up to \$67.5 million from the City of New York. ABL is one of over 40 programs being supported by this funding. See New York City Office of the Mayor, “Mayor Bloomberg Launches Nation’s Most Comprehensive Effort to Tackle Disparities Between Young Black and Latino Males and Their Peers” (news release, August 4, 2011).

fitting place to focus a YMI program.⁴ As the city and Bloomberg Philanthropies identified and evaluated the merits of potential projects across agencies, it became clear that a project on Rikers had the most promise to become a SIB. Bloomberg Philanthropies provided funding to support the ABLE program, and the SIB was seen as a strategy to expand upon these initial commitments by attracting private investment.

Notable Characteristics of Social Impact Bonds

The SIB concept is still very new, and the limited number of actual SIB arrangements makes it difficult to identify the characteristics that will define SIBs. The idea is likely to evolve in the future based on the experiences of its adopters, and as it is adapted to local circumstances. But some noteworthy elements of SIBs can already be identified:

- **Committed government partners.** Without high-level support from the Mayor’s Office and dedicated staff to pursue the idea, the New York City SIB would not have been possible. Commitment from central, influential government partners is a major asset for early SIBs, potentially a necessity for them.
- **Agreement among all parties on the metric for success.** Service providers, investors, and government entities must all support a single metric, or there can be no deal. In the New York City arrangement, the city government made a clear commitment to repay based on a specific measure of success — a reduction in recidivism. That made it possible for all other stakeholders to determine whether the terms were acceptable. It was essential that the city government knew the cost per day of keeping an adolescent on Rikers Island, and thus what constituted a reasonable price to pay for its desired outcome, keeping adolescents from returning to jail.
- **Payment based on impact.** “Impact” refers to the difference between the outcomes of program participants and the outcomes of a comparison group (a similar or equivalent population that did not receive the program). Clear and measurable outcomes are important in designing a SIB, but by themselves they do not prove that programs are making a difference that translates into real value for the government. Impacts are a far more useful indicator of success because they provide information about what would have happened to program participants if they had not received the program’s services.

⁴New York City Department of Correction, *NYC DOC at a Glance* (New York: New York City Department of Correction, 2012).

- **Withheld repayment.** SIBs identify the primary outcome(s) of concern and then spread repayment over a period of time long enough that a government entity can make its final payment after a program demonstrates success. This provides the government greater confidence in the effectiveness of the program than is available in the short term. Payments may be further delayed to allow the government entity time to realize the value of the outcomes produced. For instance, in the New York City arrangement repayment was delayed to allow the city government additional time to realize jail savings.
- **Large-scale programs.** SIBs may allow promising programs to be implemented at a scale that is not possible without private capital. Depending on the basis for savings, it may also be necessary for the program to serve a large number of people in order to reduce costs substantially (especially if a government entity is willing to pay more per unit when changes are large than when changes are small).
- **Outside investment.** Outside investment provides the initial funding to expand a program that shows promise. If successful, a SIB provides investors financial returns while achieving public good. The New York City arrangement includes both a commercial investor and a philanthropic one, in a structure designed to ensure that the commercial lender has money at risk at all times.
- **The presence of an intermediary.** The responsibilities of the intermediary organization may vary from deal to deal depending on the experience of the program operator, the level of evidence associated with the intervention to be used, and the scale on which it has been employed in the past. In a low-risk deal involving a program with a large amount of supporting evidence, the intermediary organization would identify funding partners, assist with the structuring of the SIB, and play a limited role in monitoring program implementation. For a higher-risk deal involving a program with less supporting evidence, an intermediary organization would need finance and negotiation skills and significant experience in program operations, implementation, and evaluation.
- **Robust independent evaluation.** Given the risk involved in implementing innovative approaches at an unprecedented scale, it is imperative that strong and thoughtful evaluation be incorporated into SIB arrangements. Robust evaluation offers proof that the program truly led to the desired difference.

The New York City Social Impact Bond

The New York City SIB relies on a series of interrelated contracts among the following parties:

- **The Urban Investment Group of Goldman Sachs Bank USA**, the commercial lender, made a \$9.6 million loan to the intermediary for a program that provides cognitive behavioral therapy services to 16- to 18-year-old adolescents in Rikers Island jail.⁵
- **Bloomberg Philanthropies**, the philanthropic investor, provided a \$7.2 million grant that will be used to partially repay the commercial lender if the program fails. If the program is successful, the grant will be used to support future projects. Bloomberg Philanthropies also provided a separate grant to fund the intermediary's costs.
- **MDRC**, the intermediary, worked with partners to identify the intervention and negotiate the Pay-for-Success terms, hammered out contracts with the various partners, and currently oversees the day-to-day implementation of the program.
- **The Osborne Association (Osborne) and Friends of Island Academy (Friends)**, the nonprofit service providers, administer the intervention (ABLE).
- **The City of New York**
 - **The Mayor's Office**, initiator of the SIB idea, coordinated all other city entities to structure the contracts, negotiate the terms, and oversee the evaluation.
 - **The Department of Correction (DOC)**, the government payer, agreed to pay the intermediary based on reduced recidivism and the associated cost savings.
- **The Vera Institute of Justice**, the independent evaluator, will determine whether the project has achieved the intended reductions in recidivism, which will in turn determine repayment.

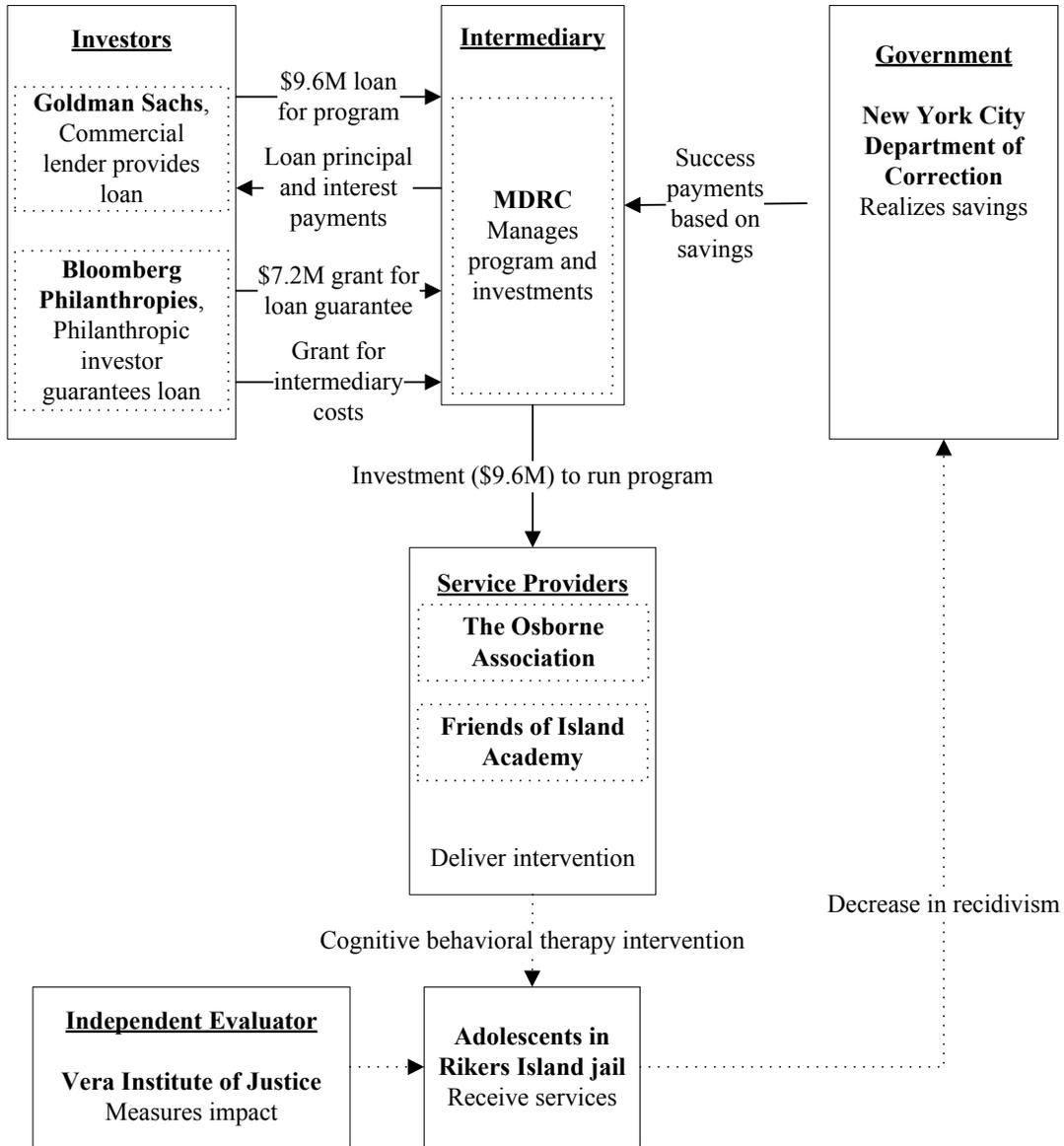
Figure ES.1 illustrates the agreements among the stakeholders in the New York City SIB and the ABLE program it finances. During their time on Rikers, adolescents participate in

⁵The loan to MDRC was designed by the Goldman Sachs Urban Investment Group and will be made from Goldman Sachs Bank USA. It is not structured as a program-related investment or foundation grant.

The New York City Social Impact Bond

Figure ES.1

Structure of the New York City Social Impact Bond



NOTES: The figure illustrates the relationships among the stakeholders in the New York City Social Impact Bond. Solid lines represent flow of funds, while dotted lines represent activities and services.

The evaluation is funded by the Mayor’s Fund to Advance NYC, a nonprofit that promotes partnerships between the city and the private sector to support public programs.

Moral Reconciliation Therapy (MRT), a cognitive behavioral treatment designed specifically to help offenders reevaluate their choices and enhance their decision-making abilities. Those who are unable to complete the curriculum while on Rikers have the opportunity to complete it afterward by attending offices in the community run by the nonprofit service providers. If the program is successful and meets its predetermined benchmarks, the reductions in incarceration should save the City of New York money and the city will then pay back the investment. If the program fails to meet the required benchmarks, the city will not achieve any savings and will not pay back the investment.

Repayment to Goldman Sachs will be determined based on two factors: the impact on readmission bed days (RBDs, also called “future days in jail”) in DOC custody during the two years after each young person is released, and the number of participants served over a four-year period. If the program results in an average reduction in RBDs of at least 10 percent while serving a certain number of participants, the city will pay back the investor.

Table ES.1 shows the potential payments to be made in July 2017 based on 24 months of follow-up for the first year’s program participants. A reduction in RBDs of 11 percent or more will provide a return above the initial investment, and the city will not make a payment if the impact is less than 8.5 percent. The Vera Institute of Justice will use a quasi-experimental evaluation approach to determine the impact of ABLÉ: a cohort of adolescents incarcerated at Rikers during calendar year 2013 will be compared to a historical group that did not receive the program. In addition to reducing the rate of readmission, enough participants must benefit that the savings cover the program’s cost. While ABLÉ aims to serve all eligible young people admitted to Rikers,⁶ it is not necessary that it do so. For full repayment to occur, the program must only serve 9,240 participants within four years (roughly 75 percent of the total projected population).

Lessons for Negotiation and Implementation

The experience of structuring the United States’ first SIB and implementing ABLÉ has generated the following notable lessons:

- **Strong partnerships are highly valuable in a SIB arrangement.** The City of New York was a critical partner. In particular, the Mayor’s Office helped build the momentum necessary to secure the support of various city agencies, and the DOC was also a key partner throughout. This arrangement also brought together a diverse set of other stakeholders. For successful negotia-

⁶“Eligible young people” includes all adolescents admitted to Rikers between the ages of 16 and 18 who are in custody long enough to enroll in school.

The New York City Social Impact Bond

Table ES.1

Summary of Payment Terms by Impact

Recidivism Reduction Rate	Department of Correction Success Payment (\$)	Net Projected Taxpayer Savings (\$)
≥20.0%	11,712,000	20,500,000
≥16.0%	10,944,000	11,700,000
≥13.0%	10,368,000	7,200,000
≥12.5%	10,272,000	6,400,000
≥12.0%	10,176,000	5,600,000
≥11.0%	10,080,000	1,700,000
≥10.0%	9,600,000	<1,000,000
≥8.5%	4,800,000	<1,000,000

SOURCES: MDRC calculations and NYC Task Order.

NOTES: The value of the initial loan to operate the program is \$9.6 million.

In addition to the minimum impacts described above, both success payments are subject to participation requirements. The program must serve a minimum of 9,420 participants over the course of its first four years of operation to trigger complete repayment. If fewer adolescents are served by the program, then success payments begin to be prorated.

Net projected taxpayer savings accounts for the DOC success payment and continued program operation for two additional years (Year 5 and Year 6). Gross taxpayer savings are purely operational savings within the jail system. A successful program would produce many other social benefits for participants, families, and local communities that are not accounted for in this agreement’s definition of success.

tions to occur, all parties had to understand each others’ organizational differences, find common ground, and be willing to compromise on individual preferences in order to reach consensus on important project objectives.

- **To be appropriate for a SIB, an intervention much be supported by evidence, be appropriate for the service environment, and be capable of being expanded to a large scale.** Moral Reconciliation Therapy (MRT) was chosen as the cognitive behavioral treatment in the ABLE program because of its evidence base and flexibility. Its curriculum is modeled on open groups participants can enter or exit at any time, is self-paced, and documents progress. These features made it expandable and appropriate to the constantly changing population on Rikers. Even so, it was necessary to adapt some elements of the program (with the permission of the developers) to implement it successfully.

- **Ideally, the program should be pilot-tested at full scale.** SIBs attract money that allows innovative programs to expand rapidly, but this expansion is likely to come with challenges. It may therefore be desirable to pilot-test a program at full scale, and only evaluate it after it achieves a steady state of operation. On the other hand, pilot programs require time and money, both of which are likely to be constrained in SIB arrangements. In this case, the trade-offs of money and time allowed for a pilot test at half scale. The experience was valuable, but certain issues came to light only after the program was expanded to full scale. Future SIBs will also probably need to weigh the benefits of full-scale pilot tests against the limitations of time and money.

Lessons for Structuring Future SIB Deals

The more attractive SIB arrangements are to private investors, the more investment in social programs they can generate. Three primary lessons learned in the New York City deal could help attract investors to future SIB deals:

- **Sharp drop-offs in repayment increase investor risk.** To attract investment, it is probably necessary to eliminate sharp distinctions between program success and failure — or from the investor’s point of view, sharp distinctions between repayment and a total loss. If a government entity truly believes that small changes in effect size represent an absolute difference between success and failure, then it may be necessary for benevolent funders to step in to “smooth the curve” for more traditional investors.
- **Early performance indicators increase investor confidence.** It is more appealing to invest in a SIB if the program it funds offers early indicators of success or failure. New, simplified methods that allow evaluators to analyze administrative data without sacrificing robustness may make these types of early assessments possible. But it will probably always be a challenge to identify short-term measures that reliably predict long-term outcomes, as was the case with recidivism.
- **Transaction costs must come down dramatically if SIBs are to become more common.** As the SIB model becomes increasingly known and accessible, standards for evidence will develop, investors will see SIBs as less new and risky, and transaction costs are likely to decrease. In the long term, if they are to be widely used SIBs will need to include set-up, evaluation, and intermediary costs in the financing of a program. In the short term, it will

probably remain necessary for some party to bear these costs outside the financing of the program.

- **Investors would far prefer SIB arrangements for interventions backed by rigorous evidence.** However, proven intervention models are likely to be in short supply. The SIB framework will therefore be more sustainable if it can incorporate rigorous evaluation, helping to build the body of evidence for various models.

Looking Ahead

SIBs have been proposed for programs that are intended to realize government savings in a relatively short time. Such projects may be a good starting place to build support for SIBs, yet the goal of most social programs is not primarily to save money, but to improve the lives of low-income and at-risk individuals and families.

Fortunately, SIBs do not inherently require that a government save money. They could be structured to encompass other goals that do not lead to government budget savings, so long as a government can identify what it is willing to pay to achieve those goals. SIBs could be designed to finance programs to increase high school graduation rates, boost college completion, improve young children's cognitive and behavioral skills, or produce better mental health outcomes for adolescents. All of these areas have promising interventions — in some cases proven ones — that could be adopted on a large scale. Additional funding for these kinds of programs is at least as hard to find as funding for programs that may generate short-term savings, and the potential benefits to society, though harder to measure, are similarly appealing.

Thus far, though, government entities have not seriously considered what they are willing to pay for outcomes in these fields. It is worth exploring whether those amounts would be sufficient to cover program costs and pay an acceptable return to investors. Current efforts to shift social and educational programs toward performance-based and incentive funding provide a foundation for this type of exploration. If SIBs are to realize their full potential, then they should be expanded beyond immediate government savings to other socially desirable goals.

About MDRC

MDRC is a nonprofit, nonpartisan social and education policy research organization dedicated to learning what works to improve the well-being of low-income people. Through its research and the active communication of its findings, MDRC seeks to enhance the effectiveness of social and education policies and programs.

Founded in 1974 and located in New York City and Oakland, California, MDRC is best known for mounting rigorous, large-scale, real-world tests of new and existing policies and programs. Its projects are a mix of demonstrations (field tests of promising new program approaches) and evaluations of ongoing government and community initiatives. MDRC's staff bring an unusual combination of research and organizational experience to their work, providing expertise on the latest in qualitative and quantitative methods and on program design, development, implementation, and management. MDRC seeks to learn not just whether a program is effective but also how and why the program's effects occur. In addition, it tries to place each project's findings in the broader context of related research — in order to build knowledge about what works across the social and education policy fields. MDRC's findings, lessons, and best practices are proactively shared with a broad audience in the policy and practitioner community as well as with the general public and the media.

Over the years, MDRC has brought its unique approach to an ever-growing range of policy areas and target populations. Once known primarily for evaluations of state welfare-to-work programs, today MDRC is also studying public school reforms, employment programs for ex-offenders and people with disabilities, and programs to help low-income students succeed in college. MDRC's projects are organized into five areas:

- Promoting Family Well-Being and Children's Development
- Improving Public Education
- Raising Academic Achievement and Persistence in College
- Supporting Low-Wage Workers and Communities
- Overcoming Barriers to Employment

Working in almost every state, all of the nation's largest cities, and Canada and the United Kingdom, MDRC conducts its projects in partnership with national, state, and local governments, public school systems, community organizations, and numerous private philanthropies.