

BUILDING BRIDGES:
Strategic Planning and
Alternative Financing
for System Reform

The Conservation Company and Juvenile Law Center
May 1994

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This paper is the product of two years of research and discussion. We have had the benefit of thoughtful critique from colleagues in federal, state and local government, including legislators and administrators; financial advisors to mayors and governors; bond lawyers and law professors; bond insurers, raters and underwriters; public policy experts and leaders of human service organizations; advocates and consultants. Everyone with whom we have spoken has offered solid suggestions and challenges. We have tried to heed their advice, recognizing that in a complex area it is impossible to accommodate everyone's suggestions. We thank everyone who assisted us, even as we retain responsibility for the final product.

The staffs of The Conservation Company and Juvenile Law Center have melded their experience in strategic planning and system reform to create this paper. Staff who contributed to this project from The Conservation Company included John Riggan, Clifford Pearlman, Carolyn Cavicchio, Patricia Owens, and Graham Finney. Staff from Juvenile Law Center included Robert Schwartz, Eleanor Bush, Sarah Nussbaum, and Elana Bluestine. We are also grateful to Larry Murray, former Deputy Commissioner of NYC's Department of Juvenile Justice and an Annie E. Casey Fellow, for his ongoing wisdom and critique of our work.

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FOREWORD

At the Casey Foundation, we have focused the bulk of our efforts on supporting innovation and reform in public policies and in the delivery of publicly supported education and human services to disadvantaged children. Even though we have seen hard-won progress in some instances, even the best conceived reforms are difficult to implement. At least two important barriers are involved: first, it is often hard for human service providers both to let go of old ways of doing business and to build their capacity and enthusiasm for innovative reforms; second, elected officials and budget chiefs are leery of reforms which fail to anticipate costs and demand for services.

Consequently, we were eager to support the work that is described in the following pages. This report challenges us to think differently about system change. It looks at reform through the intriguing lens of rigorous financial analysis. The authors provide a fresh analysis of system transformation that, in revealing its complexity, sheds new light on how such transformations occur. These insights will help any jurisdiction that undertakes to change the way it delivers education, health and human services.

The Foundation has long believed in the importance of accurate data as a pre-requisite for reform. This paper highlights the importance of financial data. The methodology prescribed here will enable planners to demonstrate the cost of continuing inefficient and harmful systems. It offers a credible set of steps that planners can take to project over time the high cost of doing business as usual. Most importantly, it offers a model for multi-year projects that will require planners to make explicit their assumptions about the environment in which they work, and about the services they plan to deliver.

In addition, the authors offer novel approaches to paying for the conversion of human service systems, *i.e.*, the transformation of less desirable systems to those that are better and less expensive than the ones they replace. (Indeed, the financing proposed here is only appropriate for those conversions that lead to real cost avoidance for state and local governments.) These approaches -- *e.g.*, bond financing and "productivity" funds -- would be strictly limited to financing the costs of conversion, not new operating costs themselves.

Foundations have long recognized that our dollars are limited, and that sound, grant-funded initiatives with strong implications for reform often go unreplicated. This paper suggests that thoughtful planning and creative financing can help turn demonstration projects into widely replicated efforts to better the lives of disadvantaged children. It also offers the possibility of broadening the constituencies committed to positive change, *i.e.*, those who focus on getting better returns on public investments. This report has thus stimulated the Foundation to explore applications of these methods in our areas of interest.

The report that follows provides a method of analysis, offers information that can build the political case for change, and suggests methods for financing change. We see this paper as the start of a larger discussion in the communities of reform and public finance. We welcome your feedback.

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PREFACE

We all want to improve or "re-invent" health and human services, for a range of reasons: to help people more effectively and thus improve client outcomes; to make efficient use of our scarce public resources; to help ensure a productive economy of the future; to create a more humane, civil society. But the harsh truth is that we are not doing very well in our "re-inventing" efforts. Yes, we know a lot more about effective, cost-efficient approaches; we know that collaborative strategies are needed to address the multiple problems of today's families; and we know that more investments must be made in prevention and early intervention. The problem is that we just aren't getting done the job of improving human service systems on any significant scale. Most creative reform efforts remain stalled as "demonstration" projects.

Over many years, many of us working in government, foundations, and nonprofit organizations have wrestled with this monster. We have come to appreciate the complexities of system change: the inertia of the established power structures, the political barriers, the competing egos and turf lines, the difficulty in communicating across disciplines and in balancing somewhat contradictory mandates, the narrow accountability structures which demand services provided rather than results achieved. This litany of woe has been articulated *ad nauseam* over the years.

Some signs of progress can be seen. State and local governments are experimenting with a wide variety of reforms, especially those involving children and families, schools and all manner of helping services. Foundations and corporations are pouring in planning, development and evaluation funding at a record clip. We are learning slowly how to overcome the real obstacles to reform and have an increasingly clearer sense of "what it takes" to achieve lasting change.

One key obstacle to reform efforts is an inadequate understanding of the financial implications -- costs and benefits -- of system reform. There are remarkably few reform initiatives which have developed economic models which predict the

expected volume and cost of new services, or the economic impact over time of system improvements or investments in prevention. A great deal more work is needed in this basic area.

Clearly, a key to moving from successful demonstrations to system-level reform is converting revenues currently committed elsewhere to fund new programs and services indicated by the direction of reform. At this time, there is only limited experience with this critical area. More typically, reform has been financed through expanding operating budgets, occasionally enhanced through revenue maximization such as tapping Medicaid, Title IV-E or other open-ended funding streams.

One of the keys to successfully implementing reform is finding ways to pay for the many costs of change: the special one-time costs of transitioning from one system of services to the "new and improved" model. For us, "new and improved" means services that strengthen families and communities; that rely less on large institutions and more on community-based services; that are unrestricted by categorical demands and that are flexible, integrated, and aggressive in building on client strengths and in meeting client needs.

We believe that identifying an acceptable way of paying for the little-understood costs of transition may be a missing ingredient in achieving system reform. This is the issue on which this paper and our efforts are focused.

We focus particularly on those kinds of change for which cost savings over time can be quantified. Thus, although they may be worthwhile, changes that increase costs (for example, adding child protection workers to reduce caseloads), or for which savings are not yet quantifiable (for example, family centers), are not the topic of this paper.

This initiative had its origins in a diner, in a breakfast discussion about "new ideas" to promote change, many of which were simply old ideas with new names ("decategorization" in the 1970s vs. "integrated service delivery" in the 1980s vs. "linkage" strategies in the 1990s, for example). We complained that health and human services are

too often locked in a "deficit" mentality, with no real sense of making investments to improve services and no attention paid to the economic implications of program policy work. Then we began sketching on a napkin a graph showing the costs of investing in reforming a human service system. We hypothesized that the costs of reforming a system would cause the overall costs of operating the system to rise for a short period of time (three to five years), but that once the transition period ended, overall costs would be less than the costs predicted pre-transition.

We also became excited about the possibility of considering the transition costs as a "capital" investment, defining capital in this case as human capital rather than "bricks and mortar." Why not issue bonds to pay for the transition period, much the way government issues bonds to build highways or hospitals or other elements of the infrastructure?

With support and encouragement from the Annie E. Casey Foundation, we have explored this simple concept thoroughly for the past two years, with a wide variety of constituencies: elected officials and policy experts; budget directors and fiscal realists; bond experts and other steely-eyed types; and program innovators and funders. While many expressed initial skepticism, virtually all became increasingly enthusiastic and excited about the potential applications.

We believe this concept has generated substantial interest because public officials believe that:

- We can't afford to expand services, no matter how urgently they are needed.
- Current programs and services are provided inefficiently.
- We know a great deal about better alternatives to many current programs, but we can't get beyond the demonstration stage.
- We don't know the costs of conversion but do know that whatever they are, no funds are available from operating budgets to pay them.

- We have only limited knowledge of how to convert currently committed funds for new purposes.
- The concept of "debt financing" to improve publicly-funded services by defining one-time transition costs over time is unconventional but neither totally without precedent nor necessarily legally impermissible.
- There is a strong and constructive movement for change responding to two forces: improved outcomes and cost savings.

We must be particularly clear on one point: despite the constraints on current funding streams and increasing demand on existing human service systems, any alternative financing mechanism for funding system transitions or conversions can not be seen as a method of merely paying for expanded services, or of taking current operating expenses "off budget." Irresponsible use of alternative financing mechanisms will spell their quick demise. All those involved in planning for system conversions will have to temper their enthusiasm about accessing new sources of funds with caution to ensure and preserve fiscal responsibility. This and other tough-minded points have been raised repeatedly by the impressive group of financial experts who have critically examined our work at all stages of development.

As our thinking has matured, we have come to regard this initiative as a new opportunity for the public sector to reallocate resources in order to get off the treadmill of ineffective policies and programs. We sorely need to understand the economic implications of reform or system change, costs as well as benefits. Economic analyses will require that reform be driven by accurate data. Once the economics are well in hand, we need the political will -- at least in a few places -- to take on system change in a financially-disciplined manner. If we are not prepared to try, then we have no right to speak of "investments" because there will be no mechanism in place to determine if there is a return on investment or not.

The financing mechanism we propose is, clearly, but one of many ways to pay for a human services transition. What is

central to our proposal -- and what should be critical to any financing system -- is the rigorous attention to the many steps that are required to move a system from its prevailing, undesirable condition to the new and improved model.

The paper which follows explores these issues in greater detail. We fully expect that it will raise many questions, some of which we have anticipated. We hope that this paper will stimulate those who have been struggling with system change. Our ongoing shared goal is to improve the lives of our neediest citizens through more effective, outcomes-oriented publicly-funded programs.

The Conservation Company and Juvenile Law Center
April 1994

BUILDING BRIDGES: STRATEGIC PLANNING AND ALTERNATIVE FINANCING FOR SYSTEM REFORM

I. INTRODUCTION

If a state had a community mental health system, and it wanted to add a mental hospital, it would do so in traditional ways. It would float a bond issue to cover the cost of design, land purchase, construction and other costs associated with putting the system's institutional component in place. If a state wished to move in the *opposite* direction, and create community-based services to replace existing institutions, it would have a much harder time finding the financing to do so. But financing, though significant, is only one of the many reasons why the public sector has difficulty making the transition from an undesirable to a desirable system. Those reasons, and our solutions, are the subject of this paper.

In the private sector, corporations have shown that they can mount successful multi-year efforts at transforming the way they do business. For instance, General Motors revolutionized its production, labor, and retailing practices to create its Saturn line of cars. Corporations can finance their change efforts by obtaining funds through the financial markets.

In contrast, governments that need or want to transform their systems for providing human services often seem incapable of mounting the multi-year efforts necessary to achieve their goals. Many obstacles can and do arise to stall or derail a government change initiative. Most typically, the funding source under-funds the change effort, in part because of pressures on the system's operating budget.

Government leadership also frequently lacks the political will to see the change through to completion, in the face of opposition. Also missing is a mechanism for ensuring that change continues across administrations. In addition, fixed terms and short-term budgets constrain long-term thinking.

On the staff side, public managers who excel at running systems often lack the skills to convert them. Even if managers understand and appreciate what it takes to implement change, line workers lack the training to deliver the new system. And the managers and line workers who must carry

out the system conversion lack incentives to ensure the success of the change initiative.

This is not to say that government is incapable of mounting *any* successful multi-year initiatives. Governments routinely mount successful multi-year capital projects, such as the building of bridges, highways, prisons, and hospitals. However, since annual operating budgets cannot reasonably accommodate the costs of such projects, which yield benefits for many years, governments finance such projects by issuing bonds and incurring medium- and long-term debt, which is then paid back over many years.

It is this lack of external and long-term financing which hampers most non-capital multi-year reform or system conversion efforts. The need for developing such alternative financing mechanisms prompted our inquiry, and led to this report.

Timing for Change is Propitious

Several exigent factors combine to make this an opportune time for policy makers, legislators, elected officials, agency heads, budget officers, and foundation program officers to seriously consider major systemic change.

- *First, ever-tightening budgets at the federal, state, and local levels require policy makers to rethink how they provide services and how they meet citizens' needs. The 1993 Fiscal Survey of States noted that "States have adjusted to the fiscal conditions of the last several years by dramatically reducing their revenue and spending projections as well as making major changes in long-term spending priorities and restructuring state government. States now recognize that the slow growth of the 1990s will be quite different from the high growth of the 1980s and that major structural change is required." As the costs of mandated programs grow and as voters become less and less willing to support additional taxes, governments must figure out how to maintain necessary services with fewer dollars and*

how to deliver those services in the most efficient manner possible.¹

- *Second*, the current fervor for "reinventing" government encourages change initiatives. An array of initiatives inspired by Osborne and Gaebler's *Reinventing Government* are now underway, focusing on increased productivity, efficiency and cost-effectiveness, and embracing private sector practices such as incentives, teamwork, total quality management and other well-established management and planning approaches. Public officials will benefit politically if they demonstrate that they, too, can operate systems efficiently and effectively.
- *Third*, many human service systems require major change in order to effectively serve their consumers or clients. For example, almost all state and local governments have written policies that prefer in-home or community-based services to institutional care. These policies cut across categorical lines. They are embedded in the deinstitutionalization movement in mental health/mental retardation, in community-based alternatives to long-term nursing home care, in support for family support and preservation services in child welfare, for mainstreaming in special education, and for community-based care in juvenile justice. In many systems, however, current practice does not yet reflect the preference established by written policies.
- *Finally*, the private sector -- nonprofit think-tanks, foundations and corporations -- stands ready to assist change efforts. For a number of years, such private entities have actively worked in partnership with governments to further (and finance) reform and collaborative initiatives. Many would welcome

¹ *The Fiscal Survey of States*, October 1993, National Governors' Association and National Association of State Budget Officers, Washington, D.C.

opportunities to achieve large-scale replication of successful "demonstration" projects.

Our Perspective

System change efforts typically have lacked two critical elements:

- the financial discipline necessary to use current budgets more effectively and change the mix of services provided, rather than simply add services on to current ineffective systems by expanding budgets; and
- the long-term strategic planning necessary to anticipate and overcome common obstacles to change.

We believe that governments have often lacked the tools to supply either of these missing elements because they have lacked sources of secure long-term funding for system conversions. We suggest that governments can remedy the lack of funding for change by obtaining access to the types of financing traditionally available only to the private sector and to public sector capital projects. To satisfy the financial markets and potential investors, governments seeking alternative financing for a system conversion will have to bring the discipline of long-term planning and fiscal analysis to their efforts.

The alternative financing mechanisms we envision will result in new sources of funding for system conversion efforts and will be a vehicle to bring about better planned, more disciplined management of systems and, consequently, allow change initiatives to be sustained.

In this report, we will:

- (1) discuss what our work and experience reveal about the nature of change efforts and obstacles to their success;

- (2) illustrate how an alternatively-financed system conversion initiative might look and what sort of planning it would require; and
- (3) discuss next steps for further development of our idea.

II. WHAT KIND OF CONVERSION ARE WE EXPLORING?

When we speak of "conversion" of a system, we mean the creation of a new system that replaces the less desirable system currently in use, or the creation of a new system that avoids expansion of the current, less desirable system. Although such conversions or reform initiatives can be of any scale, we refer to substantial transitions, such as moving from a system primarily relying on a mental hospital to a system that is community-based; or putting in place community supervision options as alternatives to building a new prison.

We focus on conversions that take advantage of innovative approaches to delivering human services within a feasible financial framework -- conversions that result in new ways of doing business rather than add-ons that cost additional dollars and do not affect the operation of underlying systems.

As part of a project for the Annie E. Casey Foundation, we have studied a successful public sector effort at system conversion: the conversion of the juvenile justice system in Broward County, Florida from a system that had relied almost exclusively on an overcrowded detention facility to one that had an appropriately utilized mix of detention services. Since we will rely on the Broward experience as a consistent example throughout this report, we provide an introduction to Broward here. (For a private sector example of a successful conversion, see the discussion of General Motors' Saturn project on page five.)

***An Illustration: Broward County,
Florida's Juvenile Detention Initiative***

As a result of severe overcrowding and excessive lengths of stay, Broward County's juvenile detention system had been the subject of litigation. In 1987, Broward's "system" was a single over-crowded secure juvenile detention center. To resolve the lawsuit, Broward participated in a five-year intensive, multi-pronged conversion effort which dramatically reduced its secure detention population (and the capacity of its detention center), brought lengths of stay within legal limits, created a mix of detention alternatives, and significantly reduced its long-term operating costs, all of which were accomplished without jeopardizing public safety.

The statistics compiled for the Broward County Juvenile Detention Center and non-secure detention programs demonstrate the results of a successful system conversion. In fiscal year 1988, the Broward County Detention Center had a capacity of 109 beds, an average daily population (ADP) of 160.8, and an average length of stay (ALS) of 16.6 days. The center was 147.2% utilized and had 71.5% of the personnel that it required in order to be adequately staffed. Broward's situation was similar to that of detention centers across the country and was a situation that typically leads to a desire to build more facilities. In Broward, however, the conversion effort dramatically changed the statistics without the expense of building a new secure detention facility.

By comparison, in fiscal year 1991, the Detention Center still had 109 beds, but the ADP had decreased to 88 and the ALS was 11.9. The center was 80.7% utilized and it had 102.7% of the staff that it required. In fiscal year 1992, the ADP and ALS had dropped even farther, to 53.4, and 7.7, respectively. The underutilization and over-staffing apparent in fiscal year 1991 meant that the Center was not being run in a cost-effective manner, but the County has since corrected this imbalance by decreasing its capacity and the number of staff members while still maintaining adequate staffing levels.

In fiscal year 1988 the only non-secure detention alternative in Broward County was home detention. The ADP for home detention was 76.8 and the ALS was 32.93. 7.03% of the children on home detention were returned to secure detention and 3.86% were charged with new law violations. In fiscal year 1992, when the non-secure detention program had expanded to include a non-secure shelter and a day program at the Boys and Girls Club of Broward County, the ADP had decreased to 64.2 and the ALS had decreased to 13.7. Only 1.84% of the children in the non-secure programs were returned to secure detention and 3.73% were charged with new law violations.

It is a significant indication of the success of the system conversion that not only did the number of children in the non-secure detention programs increase while their length of stay in the programs decreased, but also that the percentages of youth being returned to secure detention and/or charged with new violations also decreased.

These statistics demonstrate that Broward's conversion benefitted the children that the system serves by providing more humane conditions in secure detention, and also creating a range of services to allow the most appropriate placement. The conversion also benefitted the county, because it resulted in a level of operating costs lower than the county could have expected if it had maintained its institution-based system. By fiscal year 1991-92, with the transition to the new system complete, operating costs amounted to approximately \$3.8 million. Projections showed that if Broward had maintained its old system, operating costs would have amounted to approximately \$4.7 million in the same fiscal year.

The success of the Broward County conversion depended upon a number of transition costs that historically have been ignored by those who develop alternatives to juvenile detention centers. Costs included developing: a consensus for change; a risk assessment tool; a system of advocacy for individual detainees; alternatives to the point that they were fully operational; a management information system for tracking and evaluation; a training program for stakeholders; a system for recapturing federal revenues; and a system of communicating with the

public about the merits of the transition. These transitional costs are discussed more fully below.

THE SATURN PROJECT -- A PRIVATE SECTOR CONVERSION

Occasionally, the private sector mounts a change effort comparable in scope and complexity to the system conversion efforts in the public sector that we are exploring. General Motors' Saturn line of cars resulted from such a major change effort within General Motors. First contemplated in 1982, the Saturn represents GM's attempt to regain customers lost to Japanese imports and to rethink the entire auto manufacturing and distribution process. Although the Saturn story is ongoing and evolving, GM's change efforts thus far have produced revolutionary change in GM's management/labor relations, revolutionary change in retailing practices, the highest quality American-made brand of car, and very satisfied customers.

To produce the Saturn, GM managers and planners had to address many of the factors that public sector managers must address in their change efforts. Major elements of GM's transition from traditional methods to production of the Saturn included the following:

- 1) Lead time -- Eight years elapsed from the first internal discussions of Saturn to sale of the first Saturn auto.
- 2) Funding -- Estimates of GM's investment in Saturn range from \$3.5 billion to \$5 billion, including almost \$2 billion for construction of a new plant.
- 3) Relationship of the project to the rest of GM -- GM established Saturn as a corporate subsidiary, thereby insulating it from the rest of the GM corporate bureaucracy. This step can be thought of as a factor intended to help ensure that the "political will" to sustain the Saturn effort would exist.
- 4) Labor relations -- One of the Saturn planners' first major achievements was negotiation of a separate contract with the UAW. The contract established a pay scale that rewards workers for quality and productivity, and a high degree of worker participation in decision-making. The contract thus created incentives for workers to do their best to ensure the success of the project.
- 5) Training -- The introduction of new manufacturing methods, new decision-making methods, and new organization of labor required a big investment of time and money for staff development.

- 6) Manufacturing methods -- The design of the Saturn plant incorporated significant changes in manufacturing methods from the traditional assembly line.
 - 7) Distribution and retailing methods -- As a result of extensive market research, Saturn established a new style of relations with dealers and new "haggle-free" sales techniques. These new methods became a key point in GM's marketing of the Saturn to the public.
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III. WHY UNDERTAKE SYSTEM CONVERSION?

Government undertakes system conversion for a number of reasons.

Budget pressures sometimes compel governments to rethink how they provide certain services. For instance, in the early 1980s Wisconsin was experiencing rapid increases in the numbers of nursing home residents funded by Medicaid. State officials anticipated that keeping up with the demand for Medicaid-funded nursing home beds would overwhelm the state budget. These budgetary concerns prompted the state to create its Community Options Program (COP), which helped people stay in their own homes and created community-based alternatives to nursing home care.

Often, litigation compels governments to transform their systems. Examples of court-ordered transitions include the *Willie M.* program in North Carolina, under which the state developed community-based services for violent, mentally ill youth who had been warehoused in adult mental hospitals and juvenile training schools; and Pennsylvania's closing of Philadelphia State Hospital for mentally ill adults, under which Pennsylvania and Philadelphia developed a joint, multi-year strategy for replacing the hospital with an array of community services.

Sometimes, visionary members of the executive branch initiate conversion. In Tennessee, for example, The Children's Plan emerged from the governor's office as an effort to convert the state's underfunded categorical programs into a blended system of care. In the early 1970s, Jerry Miller, one of the nation's leading juvenile justice reformers, worked for governors in Massachusetts and Pennsylvania closing large public delinquency facilities and replacing them with community-based programs.

Sometimes, legislatures enact mandates that should (if properly implemented) result in system conversion. For example, in the early 1970s, federal and state laws required school districts to convert from segregated educational systems to integrated systems, mainstreaming handicapped and special education students. In 1980, Congress passed the Adoption Assistance and Child Welfare Act, which mandated six-month administrative or judicial reviews of foster care cases, to try to resolve the problem of children who were "lost" in the foster care system. Both mandates resulted, in part, from public pressure from advocacy groups to resolve long-standing systemic problems.

IV. OBSTACLES TO GOVERNMENT CONVERSION EFFORTS

Governments that want to undertake a system conversion confront numerous common obstacles that can prevent them from undertaking change at all, derail their change initiatives once they are under way, or prevent them from replicating successful change efforts on a larger scale. These obstacles are both financial and strategic.

Major system conversions require multi-year funding, which the typical funding sources available to government -- tax revenues, federal reimbursements, fees-for-service, foundation grants -- do not necessarily provide. Operating budgets fluctuate and are vulnerable to shifting political and economic pressures. Targeted federal or state funding streams may provide seed money for a change effort but generally do not cover the broad scope of activities necessary to carry out change. Foundation grants can facilitate governments'

conversion efforts, but foundation support is generally limited in amount, of uncertain duration, and limited to specific categories of service delivery.

As noted, many government change initiatives are compelled by outside forces: courts, legislatures, budget crises. When change is imposed by crisis or by outside mandate, governments usually manage to come up with the money required to make the necessary changes. Even then, however, they find just enough money to eliminate the crisis; they often do what is minimal, rather than optimal. Such allocations are often made at the expense of other human service programs. When public officials and managers of human services programs cannot point to a court order or legislative mandate that requires funding, they often cannot convince their budget officers (and other key decision makers) to fund major change efforts. The inadequacy and uncertainty of funding sources can stall change efforts that are under way or can prevent governments from even attempting system conversions.

Most state constitutions require that budgets be balanced within each fiscal year. This can be an obstacle to long-term reform. For example, in the early 1990s in Pennsylvania the state had planned to pay for additional juvenile probation officers, to be part of a new intensive supervision program as an alternative to incarcerating juveniles in state-run training schools. The state would have achieved long-term savings from reduced reliance on training schools, but it had a short-term budget crisis. In order to balance the state budget short-term, the governor "sequestered" funds for the new probation program. Thus, because the state withheld the funds needed to put the new system in place, Pennsylvania continued to operate a training school system that held more youths than necessary at enormous expense to the taxpayers.

The two federal mandates referred to earlier -- the Education for All Handicapped Children Act and the Adoption Assistance and Child Welfare Act -- are also examples of stalled reform or conversion efforts. While the legislation in both cases mandated significant changes, Congress provided inadequate funding to help states put the new systems in place. States that may have wanted to implement major changes in response to

the new laws may have felt paralyzed from the start without a source of funds to support the change effort.

In many cases, those who compel governments to undertake change, such as judges and legislators, have developed a *vision* of what a new system should look like, but have not developed a *strategy for change* to accompany that vision. Program managers, faced with a mandate to act and pressure to demonstrate results, often do not take the time to develop a strategy, either.

Government's failure to plan strategically for system conversion leads it to overlook common obstacles that can impede its efforts.

OBSTACLES TO CHANGE

Common obstacles that impede governments' efforts to convert their human service systems include:

Lack of funds. The funding source, whether executive or legislative, underfunds the change effort.

"Pockets of resistance." Stakeholder groups are overlooked that later present pockets of resistance to change.

Insufficient political will. The leadership lacks the political will to sustain the change in the face of opposition.

Change in administrations. Government lacks a mechanism for ensuring that change continues across administrations.

Insufficient capacity to manage a transition. Public managers who excel at running systems lack the skills to convert them.

Insufficient capacity to deliver the new system. Line workers lack the training to deliver the new system.

Lack of internal incentives. The managers and line workers who must carry out the system conversion lack incentives to ensure the success of the change initiative.

The "celebrated case." A single, well-publicized incident can undermine a change effort.

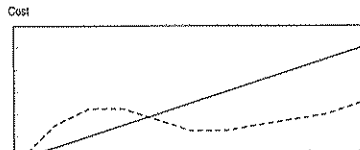
Short attention spans. Popular ideas often fail to hold public attention for very long, disappearing like fads from public agendas.

V. WHAT DOES IT TAKE TO FUND A SYSTEM CONVERSION?

Let us assume that government officials expect that their envisioned new system will cost no more to operate than the system currently in use. If the conversion from the old to the new system cost nothing, then funding would pose no obstacle for the conversion effort. Unfortunately, there *are* costs associated with system conversion: design, installation, and other start-up costs.

Furthermore, because the current system provides needed services, government must continue to operate the current system while it builds and installs the new system. This need to provide funding for two systems during the transition from the old to the new system causes a bulge in program costs.

The costs over time of a system conversion might look something like this:



The straight solid line shows the projected path of net expenditures for the existing program. The dotted line shows the costs of transition leading to an alternative system. Initially the costs for the transition are greater than the existing baseline program, but these fall below the baseline after year four. The higher costs of the transition period can be offset by savings resulting from the alternative program in later years. The bulge depicted in the graph, between points A and B, represents the costs of transition.

This graph makes several simplifying assumptions in order to illustrate the basic concept of one-time transition costs for system conversions. The costs of the existing program increase at a constant rate, in part to reflect traditional

incremental budgeting practices. The costs of the alternative program are lower than those of the existing system, because lower costs form a key part of the rationale for conversion of the existing system. Costs of the alternative program also increase each year after the transition period ends, a fairly conservative assumption. The many other possible shapes of the lines in this simple graph point up the need for further documentation of actual system conversions and the need for careful, thorough analysis of costs, revenues, and demand as part of planning for a system conversion; these needs are discussed later in this paper.

Our study of the conversion of the Broward County juvenile justice system included careful examination of the costs associated with the reform effort. The Broward data, although only covering five years and not ten as does our hypothetical graph, did bear out our view of the costs over time of a system conversion.

The following chart shows the projected costs of Broward County's juvenile detention system, if the situation which existed in 1987 had been allowed to continue; the actual costs incurred while continuing to run the secure detention facility while at the same time putting into place community-based alternatives; and the additional costs or savings experienced each year relative to the projection. One can clearly see that the costs of transition peaked in 1989-90; by 1992, the costs of running the improved system were almost \$1 million less than the projected cost of the old system.

Over the five years of conversion, the actual costs of running the system *and* paying for the conversion were actually \$1.43 million *less than* the projected costs of running the old, unimproved system for that same five-year period.

BROWARD COUNTY, COSTS OF CONVERSION

Fiscal Year	Projected Costs Without Conversion	Actual Costs During Conversion	(Additional Costs)/ Savings
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1987-88	\$2.93 million	\$3.03 million	(\$100,000)
1988-89	\$4.3 million	\$3.85 million	\$450,000
1989-90	\$4.44 million	\$4.65 million	(\$210,000)
1990-91	\$4.58 million	\$4.18 million	\$400,000
1991-92	\$4.7 million	\$3.81 million	\$890,000
TOTAL	\$20.95 million	\$19.52 million	\$1.43 million

One important lesson is understanding the cost of conversion. At the beginning of the Broward reform, no one could predict the real costs. However, this analysis reveals a surprisingly affordable conversion cost, so low, in fact, as to not require an alternative financing mechanism.

Planners and policy makers should assume that funding for the operating costs of a new system will come from agency operating budgets, just as it always has. The challenge of converting a system lies in locating or creating a source of funds to pay for the costs of the conversion.

VI. ALTERNATIVE FUNDING MECHANISMS

The costs of transition are limited in duration, quantifiable, and separate from the ongoing operational expenses of either the current or new system. An ideal alternative financing mechanism would provide funds up-front to pay for the costs of transition and would allow repayment of those funds over time.

Typical financing mechanisms for government capital projects meet our criteria for an alternative financing mechanism. When governments issue bonds to finance construction of a bridge or a building, they receive the proceeds from the sale of the bonds up front and repay the borrowed funds over time. Thus, they pay the costs of changing their system without creating a "bulge" in their operating budgets.

The theory underlying the use of public debt to finance "capital" projects is that those who benefit from a "service" (e.g., annual use of a building) should bear an appropriate portion of the cost of "creating" that service (i.e., the cost of designing and building the facility). In our view, that theory can apply to human service reform projects as well as to traditional capital projects.

Broward County funded the conversion of its juvenile justice system with a mix of general fund dollars and foundation grants. Once fully in place, Broward's new system achieved significant cost reductions compared to the prior system. In cases like Broward's, where one-time expenditures incident to designing and putting a new system in place result in a less costly or a better system, spreading the transition costs over a number of years might have been an option. What alternative financing mechanisms might have been available to fund the transition costs of the Broward conversion?

Public Debt

States vary in the way they limit the use of debt. Most state laws would pose no legal barriers to the general concept of issuing bonds to fund a system conversion. To the extent that barriers exist, they apply to debt financing in general.

There are two general categories of public debt: general obligation bonds and revenue bonds. With either type of bond, Broward County's plan to convert from reliance on institution-based juvenile care to include significant community-based services would have had to satisfy the "public purpose" doctrines that usually apply to government bonds. These doctrines are intended to restrict public funding to activities that serve the interests of the public at large and to preclude governmental participation in activities that serve only a small group of individuals within the community. Funding a change in juvenile care should meet the requirements of the "public purpose" doctrines, since the issue of juvenile care is pertinent to "the public at large."

With both general obligation and revenue bonds, the issuer will have to specify the "useful life" of the project. The useful life of the project, which determines the payback period for the bonds, should be long enough to justify capital funding; the most likely duration for bonds issued to cover transition costs would be five to ten years.

With a general obligation bond, the issuer incurs debt for which it pledges its full faith and credit, to be repaid from any and all sources of revenue (*e.g.*, property taxes, income taxes, state appropriations, federal revenues). For Broward County to have issued general obligation bonds to fund its system conversion, it would have had to meet any applicable Florida requirements regarding issues such as voter approval and debt limits. These issues exist in most states, and generally the answers depend on the particular state's constitution. Issuers of general obligation bonds rarely, if ever, default on such debt.

With revenue bonds, the issuer repays its debt from specific revenue streams. The key challenge lies in identifying revenue streams that the issuer can pledge to repay the debt and that the credit market will accept. Traditionally, revenue bonds are used to finance revenue-producing capital projects, such as toll bridges or water works systems; the tolls paid by users of the bridge would be used to pay back the bonds.

Although a system conversion probably would not result in traditional revenue-producing activity, revenue bonds for financing transition costs could be secured by one or more sources of income available to the issuer, including federal reimbursement payments, other third party fee-for-service payments, receipts from specific taxes and, finally, annual appropriations from the legislature.

Assuming that the Broward County conversion had been of a larger scale and therefore more expensive, how might Broward have used a revenue bond to finance its system conversion? Recall that Broward's system change resulted in considerable operating budget savings. Perhaps Broward could have issued revenue bonds and pledged future state appropriations to repay them. Broward's budget officer would have "earmarked" the

expected operating savings from the conversion for future debt payments, while the bond buyer would have relied on the legislature's willingness to appropriate funds as pledged (whether or not the operating savings materialized).

Internal "Loan" Funds

There are a number of legal and practical hurdles to overcome in issuing debt: Is this a purpose for which debt can be issued? Do the transaction costs overwhelm the benefits of a relatively small initiative? Any one or more of them may prove insurmountable.

If Broward had rejected the option of issuing bonds, perhaps it could have created an internal fund, such as a productivity fund, to serve as an alternative to the public bond market. An internal fund operates as a revolving loan fund, limited in size and scope. A decision-maker picks among "applicants" for funding, such as various agencies of government, or perhaps even nonprofit organizations. Typically, the decision-maker awards funds to applicants who demonstrate that their projects will enhance their productivity. In Broward's case, the expected operating cost savings of the conversion could have qualified the project for a grant from such a fund.

Traditionally, productivity funds have been maintained through annual contributions. A fund could be established through an appropriation from one or more annual operating budgets until the fund reached a certain level (similar to the manner in which some states have created "rainy day" funds). Alternatively, the fund could be created by the legislative earmarking of certain predictable tax revenues, and thus have no maximum level.

The use of annual set-asides to sustain an internal fund tends to limit the sorts of projects the fund can support. Perhaps government could create a fund large enough to support a system conversion (or to support several change initiatives) by issuing revenue bonds secured by predictable tax revenues. "Sin taxes" are often used as an example of funds that could secure a debt issue.

Broward, in fact, obtained funding from a state-level productivity fund to pay for the computers needed to develop a management information system capable of tracking and evaluating the new system. If a larger fund had been available to Broward, grants from the fund could have replaced the operating funds and/or foundation grants that were needed to pay for Broward's conversion.

Special Purpose Authorities

Broward could have considered creating a special purpose authority as an alternative to issuing bonds directly. The creation of special purpose authorities requires state legislative authorization, although there may be existing authorities that can be used to finance some transition costs.

The authority would have the power to issue revenue debt instruments, which will be secured by a specific revenue stream or by future government appropriations. Equipment leasing authorities, for example, are found in many jurisdictions. The bond buyer is technically relying on future annual government appropriations to make the payments due on leases for police cars or computer systems, or (in the case of hospital financings) third-party fee-for-service payments to pay for expensive medical equipment.

Once established by the state legislature, the authority does not need to seek political or public approval each time it decides to issue debt. Thus, if used to fund a system conversion, a special purpose authority might protect the conversion effort from changes in political climate or weakening of political will to complete the conversion.

IX. PLANNING FOR CONVERSION

Private sector entrepreneurs often use a "business plan" as a tool to attract financing for their proposed projects. A typical business plan describes the business and the environment in which it functions, its short-term objectives and longer-term goals, and the strategy it has developed to achieve these

objectives and goals. The plan includes a detailed schedule for implementing each of the strategies identified; identifies marketing, production, management, personnel, and financing tasks; and addresses how tasks are to be coordinated.

Business plans often discuss risks and problems that may delay or prevent implementation of intended strategies and should outline plans to minimize or overcome the risks and problems. Business plans include financial statements showing projected capital and operating costs, revenues, and cash flow for a two- to five-year period. Finally, business plans may address the financing needed to fund implementation of the plan, including identification of sources for the needed funds.²

To gain access to the alternative financing mechanisms we have discussed above, government will have to bring to its planning the same long-term view, rigorous fiscal analysis, and disciplined consideration of strategy that characterize good private sector business plans.

A good plan for a human service conversion will:

- Describe clearly the vision of the new system, including projections of the costs and revenues associated with the new system;
- Establish a time-line for the transition from the old to the new system;
- Identify the costs of transition;
- Anticipate barriers and address building of support for the conversion;
- Predict and plan for the amount of error/failure that the conversion effort can tolerate; and

² Curtis, Kristina and Paul Berney, "The Business Plan," Yale School of Organization and Management Smaller Organizations Program; New Haven, CT.

- Address and explore the financing mechanisms that may be available to fund the conversion.

Below, we discuss in more detail each of these aspects of a good conversion plan.

Describing the Vision of the New System.

In order to envision and plan effectively for a new system, the planners should share a clear understanding of the current system. Achieving such an understanding depends on documenting and maintaining specific data, including financial data, on the existing system.

Lack of hard data from well-documented studies can often be an obstacle to moving forward. In the mid-1980s in Philadelphia, for example, a juvenile justice "stakeholder" group that met to address detention center overcrowding lacked data to describe the reasons for overcrowding. As a result, each member of the group used its own worst case examples as evidence of detention problems, often with drastically opposing views. Such anecdotal evidence proved to be a poor substitute for data that all of the stakeholders could accept as a basis for moving forward to change the system. A stalemate resulted.

The importance of accurate data to the success of conversion would be hard to overstate, yet very little cost data exists in most systems. Collecting data on current costs should include personnel, operating and capital costs. Developing an understanding of the current system should include projecting the future costs of simply maintaining the current system. Assumptions regarding future costs of the current system should be detailed and related to demographic, political and economic factors that affect the system.

From the shared understanding of the current system, the planners must imagine the new system. They must achieve a meeting of the minds of those who control the dollars -- such as state budget directors -- and those who create policy, *e.g.*, the governor's policy staff and elected officials. There must be

agreement on a program that serves people, saves dollars, and can be "sold" given the prevailing political environment. A meeting of the minds must include agreement on what the new system must achieve to be considered successful. "Success" can be measured by programmatic changes and by fiscal considerations. For example, in the Broward County juvenile detention conversion, success was defined by both a reduction in the number of children in secure detention *and* by a redistribution of dollars that left the newly created system no more expensive than the original.

As they work toward a common vision of the new system, the planners should identify, as best as possible, the operational costs of the "new" system once implemented, including personnel, operations and capital costs and relate those costs to appropriate assumptions. Planners should also identify any new sources of revenue that the new system might attract. Depending upon its design and implementation, a new system might qualify for federal revenues and reimbursements that might not otherwise be received, such as Title XIX, Title IV-E, and other revenue streams.

Establishing a Time-Line for the Transition.

The duration of system transitions will vary widely due to each system's unique features. An estimated duration of transition is essential in choosing which financial option might best serve to fund the conversion. Financiers have advised us that the most likely duration for bonds issued to cover transition costs would be five to ten years. Broward's system conversion was completed in approximately five years. Of course, during this time it was necessary to maintain and modify the old system while bringing the new system on-line. Thus, in addition to having a vision of the new system, planners must consider how they will phase in the new system and phase out the old.

Identifying the Costs of Transition.

Key in planning any system conversion is figuring out what the costs of the transition will be, separate from the ongoing costs

of old and new system operations. Planners intent on overcoming predictable obstacles to change efforts can expect that their strategies to overcome the obstacles will carry costs with them. Thus, once comfortable with imagining the new system, the planners must identify those specific costs which may be associated with the change from the old system to the new system.

In addition, in order to assess whether it is worth investing in the new system through an alternative financing mechanism, planners must evaluate the costs of the existing system and of transition in a uniform way. Dollars will have different value over time. There are many financial tools used to analyze a new venture, but the one most applicable to a system transition is the use of net present value (NPV). This type of valuation forecasts the cash flow, includes the time value of money and the risk involved in the project, and uses the opportunity cost of capital to discount the future expenditures of and benefits from the project. Analysis of cash flows using net present value allows planners to compare the costs of running the existing system with the costs of converting the system. An additional reason to use net present value is that, regardless of the complexity or mix of the system and the available planning options, planners will be able to compare financial "apples" to "apples."

The Broward experience suggested a number of specific transition costs, including:

- ***Developing a consensus for change:*** Broward reformers used a mediator to help settle their detention center litigation. Whether or not a system incurs the cost of mediation, it will inevitably pay for some sort of process that begins the transition. These costs can be classified as "project planning" costs.
- ***Developing substantive elements of the new system:*** A new system will require creation of new substantive elements. In the Broward conversion, we identified two important elements that had to be developed before the new system could work.

The Broward planners developed a "risk assessment" instrument. This tool assessed a juvenile's risk of recidivism and likelihood to appear in court and provided the essential culling mechanism for secure detention. The costs involved in this process included both direct costs (a legislative task force which codified the instrument) and opportunity costs (the time spent by operational staff in the process).

The Broward reformers had to develop alternatives to the detention system that would continue to keep the integrity of secure detention goals, *i.e.*, seeing that youths do not commit other crimes while awaiting trial, and assuring that they appear in court as ordered. Costs involved in developing alternatives included all the planning, recruiting and consulting involved in finding and developing alternative providers, such as travel to potential sites, purchasing of a shelter building, *etc.* It did not include the costs of operating alternative programs, once they were fully up and running.

- ***Building capacity of personnel to deliver/use the new system:*** Training of all relevant constituencies is one of the most expensive but most important costs of transition. In Broward, not only did the Department of Health and Rehabilitative Services staff have to be trained in the new system, but so did the police departments, defense attorneys, prosecutors, judges and others who were stakeholders in the system. Training also included trouble-shooting when celebrated cases created problems for the transition.
- ***Tracking and evaluating the reformed system:*** Planners, public officials, and others must be able to measure the success of the new system. Thus, a Management Information System (MIS) that can collect pertinent data, analyze the data and report information in a timely manner to decision makers is key to system conversion. In the Broward example, MIS hardware and software helped to implement the risk assessment tool and collected secure detention

data. In addition, it provided case work information to managers. MIS costs included needs assessment, design, development of software, hardware and training/operating costs associated with implementation.

- ***Building support and advocacy:*** In order to build support for the Broward system conversion, an attorney/consultant was retained to represent individuals in juvenile court who were arguably eligible for release. This individual provided critical advocacy for the reform effort with key stakeholders within the juvenile justice system. The role played by this participant in Broward's conversion illustrates the importance of recognizing and creating a role for "outside" advocates to ensure the success of the conversion effort. Individual case advocacy, of the sort that occurred in Broward, is one example of such a role.
- ***Marketing the system to the public:*** Building community (taxpayer) acceptance of the changes, preparing the media for celebrated cases, describing successes in professional publications, and inviting visitors to inspect the new system are important to ensuring endorsement of the new system and protecting from premature attacks during transition.

Generally, these activities will not take place in the initial stages of a transition, but planners should keep in mind the need to meet with newspaper editorial boards, heads of local corporations, and other "opinion leaders."

- ***Capturing new revenues:*** Depending upon its design and implementation, a new system can attract new sources of revenue, in particular federal revenues and reimbursements that might not otherwise be received. Transition costs would include research costs, initial applications, and proposal writing, but would not include routine operational costs for capturing the revenues.

*Anticipating Barriers and Building Support
for the Conversion.*

The costs of transition we have identified represent costs that we expect would accompany almost any effort at system conversion or reform. As we noted, some of the costs are for activities necessary to overcome predictable obstacles to change; for example, including expenditures for training should help overcome predictable lack of capacity to deliver a new system. Any conversion effort will also present unique factors or situations that may pose barriers to successful change. To the extent possible, planners should anticipate such barriers and build the support necessary to avoid or remove them.

For example, the planners must understand the political environment in which the system exists, and account for any political considerations. Will an upcoming election campaign affect the framing of the conversion effort? Does the composition of the staff in the existing system reflect the influence of political patronage? If so, how does that affect plans for training and possible reassignment of staff members? Does the conversion entail selection of sites for community-based programs? If so, how will the planners convince community members and their leaders to accept the program?

Planners must also understand the legal environment in which their system exists. Will they need waivers of regulations or favorable legal interpretations before they can proceed with the conversion? If such determinations are needed, the planners should consider how they will go about obtaining them, how long it may take, and whether they can develop fallback plans in the event that they do not receive favorable determinations.

When thinking about building support for the conversion, the planners should carefully consider the size and composition of the group they intend to consult as part of the process. Sometimes, change efforts fail because the planning group becomes too large and founders under its own weight. The "least/most" principle might be brought into play here:

engaging the least number of people, who can represent the most diverse and important constituencies.

Most important, after identifying costs and revenues, planners will have to determine whether investment in the proposed system conversion is indeed worthwhile. Using net present value, discussed above, planners and policy makers will be able to determine whether there will be a sufficient return on investment to justify using alternative financing.

Predicting and Building in a Margin of Error.

All planning, in the private sector as well as in the public sector, takes place in a state of uncertainty. Good business plans acknowledge areas of uncertainty and analyze the projects they propose by varying key assumptions to test the range within which a proposed project remains worthwhile. A good plan for a system conversion should do the same.

This sort of "what if" analysis requires a high degree of interaction between the policy/program side and fiscal side within a government agency. Each side needs to ask "what if" questions of the other and to push each other to examine a range of options and assumptions.

How to predict and control the demand for the system's services presents a particularly tough planning challenge. Unlike private businesses, which may welcome unanticipated growth in demand for their products, government may need to control demand for its services in order to ensure that its system conversion generates expected savings. The need to control demand, and to predict how much "error" the system can tolerate, can play out in several ways.

If the "old" system will continue to exist along side of the new one, planners must devise a way to prevent or limit growth of the old system. The Wisconsin Community Options Program (COP) previously mentioned presents an instructive example. In approving COP, the state imposed a cap on the number of licensed nursing home beds in the state, which became a critical factor in implementing the program. Dollars that had

been budgeted for projected expansion were used to pay for new community-based services. Multiple studies over a ten-year period (1980-89) revealed a net decline in Medicaid-funded nursing home residents of over 7,000, although long-term projections had predicted an 8,000-resident increase.

If government has done its job well, the new system will represent such an improvement over the old that it will create an increased demand for services. The new demand can be managed by controlling the per-diem cost of service for the new system, or by controlling the length of stay in (or use of) the new system. (The latter would be akin to utilization review).

With implementation of any new human services system comes the risk of inappropriate demand for the services, or "net-widening." Net-widening refers to the provision of services to clients or consumers who were not served by the old system, and for whom the new system was not intended. Examples abound in juvenile justice.

In order to combat overcrowding in secure juvenile detention centers, many communities have established alternatives like group homes and foster homes. It has been generally true that courts have then placed into these alternative settings youth who previously would have stayed at home with their parents. In that situation, there is little impact on the secure detention population, but the detention net is widened to pay for group and foster home placement of new youth in the system; instead of reducing costs or the overall detention population, an increase in both results.

When planners confront a system in which net-widening can occur, they must (1) devise controls to ensure that the new system serves primarily those targeted to receive services, and (2) calculate how much net-widening the new system's finances can tolerate. Broward County's risk assessment instrument helped to avoid net-widening. The data from Broward shows that as average daily population in the non-secure detention alternatives increased, average daily population in the secure detention center decreased.

We note, however, that before implementing the new system, Broward's planners could not have known precisely the level of "legitimate" demand for the non-secure alternatives. The transition itself helped to bring about an understanding of the appropriate mix of secure and non-secure placements. Thus, to fund such a transition with some form of debt financing, planners in places like Broward County will have to invest more in accurately projecting legitimate demand for services over a multi-year period. While planners must anticipate net-widening and devise mechanisms to control it, they should expect to refine their plans as the transition progresses and they gain experience with the new system.

Addressing Financing Mechanisms.

As mentioned above, private sector business plans often serve as tools to attract funding for proposed projects. While a plan for a public sector conversion effort may serve this purpose, it may also provide a vehicle for addressing strategic issues related to financing the conversion. Planners could consider using the plan to explore several potential financing mechanisms, from use of current operating funds to any of the potential alternatives we have presented.

We stress again that we do not intend the financing mechanisms we have discussed to serve as vehicles for moving regular operating budget expenses "off budget." Budget officers and others who participate in planning for a system conversion must guard against unwarranted expansion of the concept.



The sort of planning we have described is difficult, but necessary to gain access to the alternative financing mechanisms we envision using to fund transitions. The planned use of these alternative financing mechanisms requires policy makers and program staff to set forth a comprehensive vision of the future and a strategy for identifying and deploying the resources deemed necessary to get there. For government to think about costs and financing strategies over time, it *must* think in detail about the structure of its programs.

To us, this is the most important aspect of linking system conversion with financing strategies.

VIII. FURTHER CONSIDERATIONS

We have laid out a new concept and potential new approach to fostering reform of health and human services programs: devising alternative financing mechanisms to pay the one-time transition costs of a system conversion and linking strategic planning to the financing strategies. In doing so, we have analyzed strategies for paying for transition costs, especially through debt financing.

We have explored this concept extensively over the last two years, examining its legal, financial and policy implications. These discussions have generated a great deal of critical interest and, in numerous cases, enthusiasm, particularly in the public policy community. We conclude that the notion of financing system transitions has considerable potential and that the timing is indeed propitious for going forward with this effort.

Here, we flag some of the important questions and issues that interested policy makers must consider to determine if the concept holds promise for them. We then identify some of the potential applications of this concept.

QUESTIONS AND ISSUES

Policy makers must confront important questions and issues if they wish to pursue this concept.

- *Does your system have the capacity to do multi-year budget planning?* Projecting costs and revenues over time constitutes a crucial aspect of the planning we encourage. Thus, if your system cannot already handle this sort of analysis, you will need to build that capacity.

- *Do the necessary economies of scale exist to justify the use of an alternative financing scheme?* Many transitions, thoughtfully developed, are small enough to be funded through operating budgets. In such cases, it may not be worth the effort, or the expense, to develop an alternative financing mechanism.
- *Do legal barriers exist in your state or county that might prevent alternative financing mechanisms from being used?* There must be an absence of legal barriers for the type of financing mechanism contemplated for the transition. In the face of barriers, clear evidence must exist that all necessary actors are willing and able to remove them before a conversion can be planned.
- *Does your system have the capacity to track its consumers and costs?* As we discussed above, planning for change must build from a clear understanding of the current system and how it functions. Your management information system should be able to provide data about the current system, show what it will cost to change the system, and monitor the changes to determine where the cost savings appeared. Development of the MIS may be considered a cost of transition.
- *Does your staff have the capacity to plan for and implement a new system?* Staff that excels at delivering services is often unskilled in strategic planning. Most managers have skills that are limited to running systems, not converting them. Building the capacity of your staff to think about, plan for, and undertake change may constitute the first step you must take before pursuing any of the ideas we have put forward.
- *Can you structure your conversion effort to create internal incentives or rewards for success?* Often, government does not reward program managers for successfully changing their systems. For example, government may respond to a program manager who succeeds at producing new revenues or cost savings by reducing the manager's budget in future years and

applying the new revenues or savings to other areas of its operations. We believe that you will increase the chances for a successful conversion if the unit of government that implements the successful conversion receives the benefits of cost savings or new revenues that flow from the conversion effort.

- *Does your system carry inherent limits on the length of stay of persons served by the system?* This question arises from the difficulties of controlling demand for a system's services. The new system must be designed to be able to accommodate new entrants. If the length of stay in the new system is longer than in the old, there will be an expansion of the number of persons served. Thus, to avoid the length-of-stay problem, state officials who undertake a transition might want to begin with an "acute"-care system, such as child welfare or juvenile justice, rather than a "chronic"-care system such as mental health or mental retardation.
- *How strong is the political will to change the system?* Political will is different from general interest or willingness to undertake change -- many politicians will support a project until it becomes controversial. Further, when a political administration changes, the political will behind a planned conversion may evaporate. If you are considering undertaking a system conversion, you will want to assess the factors that may ensure the necessary political commitment. Such factors may include:
 - ▶ the agreement among the key players that, in the absence of reform, the present trends will result in costs that exceed the system's ability to pay;
 - ▶ the necessity for change that comes from having expensive construction plans on the books, from severe financial pressures arising from over-use of an institutional-based system, or from court orders or other external mandates requiring major expenditures;

- ▶ the support and involvement of advocacy groups, the media and grassroots or community-based organizations, as well as the recipients of services.

We note as well that use of an alternative financing mechanism should help to insulate a conversion effort from political pressures and weakening of political will. If bond financing is used, the mechanisms we have explored must generate adequate revenues to cover the debt service. Any financial markets accessed will require constraints on the use of the funds and repayments on agreed-upon schedules.

- *Might the structure and discipline required by an alternative financing mechanism result in displacement of consumers to other systems?* The necessity of controlling demand in order to control the costs of the "old" and "new" systems may result in direct displacement of consumers to other systems, with little real savings to government as a whole. Thus, even as you focus on a discrete, definable conversion, you should think about the impact of the conversion on other systems and services. While displacement itself is not necessarily undesirable, the costs of displacement must be built into the overall economic analysis.

POTENTIAL APPLICATIONS

The potential scope of an alternatively-financed system transition is quite broad. While we have not explored the following applications in depth (with the exception of juvenile detention), we include them here to stimulate further discussion about the possibilities of promoting alternative financing models. Each would have to be subjected to careful analysis examining feasibility in each potential location. Some of the criteria to be applied in considering candidates for alternative financing of transitions include the following.

1. The conversion involved must be clearly defined and observable, such as a conversion from an institutional setting to community-based services.
2. The transition period must be of a reasonably short duration, and be progressive in nature.
3. The particular program or service being converted can be a component or element of a larger system, but must be pivotal to achieving the reform of the system itself, acting as a lever of change.
4. Some kind of formal limit must be set on the old system (by legislation or court order) requiring it to either shrink, stop growing or grow at a reduced rate.

Though not definitive, the following are program areas in which alternative financing mechanisms might be employed to finance a system conversion.

- ***Juvenile detention:*** Alternative financing can help sites to put into place a range of community alternatives, similar to the array used in Broward County, to reduce over-crowding and avoid new construction, and also avoid unnecessary placement of youth in secure facilities.
- ***Juvenile corrections:*** Some states, anticipating the baby "boomlet," have plans to construct new youth correctional facilities. Alternative financing can create community-based systems that will get those states through a period of short-term increased demand without incurring long-term costs.
- ***Pre-natal Care:*** A highly targeted strategy would be to provide an array of pre-natal care (such as education and home visits) to pregnant women at risk of having premature, low-birthweight babies. The purpose, measurable over time, would be to reduce the number of highly expensive life saving measures currently required by such infants.

- ***Child welfare:*** There are a variety of applications for alternative financing, taken together or separately, that can be used to transform child welfare systems. For example:
 - ▶ ***Family Preservation.*** There is a cost to developing Family Preservation Services on a scale that is large enough to reduce significantly the foster care population. Transitional costs might include contract development, recruitment of workers, training of all potential referral sources, coalition-building and marketing of FPS.
 - ▶ ***Foster Care Reform.*** There are costs incident to any foster care reform that moves, for example, from institutional care to family foster care. Such costs might involve coalition-building, designing or re-tooling a management information system, recruiting and training new foster parents, and training of everyone in the system, from caseworkers to judges, lawyers and political leaders.
- ***Child support:*** This is a unique opportunity because it potentially generates revenue, which can be used to repay bonds. Alternative financing could pay for establishing in a state a system of child support enforcement that, if it results in increases in child support, will be paid back in part by federal Title IV-D funds and, for part of the population, reduced public assistance payments.
- ***Mental health:*** This is a field in which there are numerous types of conversion for which alternative financing has a role. One example could be to convert from a system dependent upon private psychiatric hospitals to a system that is community-based and under a system of managed care. Transitional costs might include developing the local service capacity, or augmenting local MIS capability, to help local sites manage under their capped allocations.

In addition to the above applications, interest has been expressed in a variety of child health applications (*e.g.*, prenatal care and home visits to reduce the number of low birth-weight infants requiring expensive hospital procedures and extensive follow-up) and primary prevention approaches (*e.g.*, targeted interventions for at-risk families -- based on substance abuse, school truancy, or involvement with law enforcement -- designed to minimize child abuse and subsequent out-of-home placement).

Another potential area would be financing comprehensive school-based approaches such as family support centers, afterschool programs, *etc.* Education reform might also be considered a system conversion, with transitional costs involved in training teachers and parents, purchasing new equipment, *etc.* Although potentially desirable initiatives, these applications would require reliable ongoing funding streams to fit our "system transition funding" model. However, they bear further study for possible action at a later stage.

We have also identified numerous potential applications outside the children and youth area. A partial list includes adult corrections, deinstitutionalization of mental hospitals, and community alternatives to nursing homes, among others.

IX. WHAT COMES NEXT? AN INVITATION TO STATE LEADERS

During the coming year, we will be building interest in our work, developing a better understanding of system transitions and documenting their costs, developing demonstration projects, and exploring models of evaluation.

We have concluded, as a preliminary matter, that state government is the most appropriate issuing authority for capital funding of transitions, and that state-wide change efforts are most appropriate for alternative financing, to benefit from economies of scale. In addition, states can issue bonds, and have the most flexibility in folding debt repayment into future operating budgets. However, although we have a

preference for state-level systems, this is not without exceptions. The choice will likely depend upon the system that is being converted, as well as local political issues. The key is whether the system is of a sufficient scale to warrant alternative financing. In some instances, a large city or urban county could achieve sufficient economies of scale to make an alternatively financed system conversion worth pursuing.

1. Our work will not be done in a vacuum. We need to hear from governors, legislators, budget officers, funding experts, and administrators -- in short, from those in state government who have a vision and a belief that the work of government can be done differently to improve human services. We invite state leaders and financial experts to join us to *create an informed dialogue* -- through conferences, dissemination of written materials, additional meetings with policy makers at the federal, state and local levels, and discussions with other key informants.
2. We must *further document the process of system transition*, so that we can examine change efforts in systems other than juvenile justice, and learn how the process of transition varies from system to system.

While we use Broward County's juvenile detention conversion as an example throughout this paper, we acknowledge that the Broward transition may not be the best example for an alternative financing mechanism: the cost of transition was small enough to have been absorbed by the operating budget; the system itself was quite small, making the transition easily manageable; and data suggest that the detention center was so overutilized at the beginning of the transition that savings were easily realized.

We welcome information on other successful system conversions, no matter how they were financed, so that the costs of transition and the process undertaken can be used in the further development of the alternative financing model.

3. It is crucial to move beyond the theoretical stage and begin to gain experience with alternative financing approaches to transition, through the *creation of demonstration projects*. Such demonstration projects will critically examine and test the sites' ability to:
- ▶ manage a controlled transition from one system/approach to a "new and improved" approach;
 - ▶ calculate the true costs of the system transition;
 - ▶ control costs of old and new systems while achieving social policy objectives;
 - ▶ form an effective partnership between political, financial and program people with impact beyond the demonstration period;
 - ▶ contain and retain all revenues generated by the project;
 - ▶ create an effective MIS to fairly measure program outcomes and costs, both direct and indirect; and
 - ▶ effectively establish a political "win" for reform and affordable financing.

Any demonstration project will have to develop, as a component of the strategic plan for changing the system, an alternative financing plan with criteria for use of such financing. The duration of the transition must be determined, along with the financing mechanism and revenue stream. While we discussed several potential mechanisms -- public debt, internal funds, or special authorities -- other innovative financing strategies may also be applicable and should also be explored.

4. In addition to demonstrations, it will be important to ***conduct evaluations of the transitions funded through alternative financing mechanisms***. Evaluation of these efforts will have to go beyond traditional evaluations of process and substantive outcomes, though both of those are useful and should be part of a comprehensive evaluation. A comparative evaluation of the range of financing mechanisms that states choose when implementing their reforms could be undertaken.

We are eager to further develop effective methods leading to better utilization of our critically needed health and human services resources. We are looking forward to expanding our understanding of system transitions and financing strategies. We welcome the opportunity to work together with public and private leaders to turn our vision into routine practice.

APPENDIX A

Planning Tool for Determining Costs of System Conversion

State or local governments that are planning reform, with or without alternative financing, will need a methodology to project the costs of reform. A viable financial projection will help staff appreciate the complexity of the proposed change. It will help ensure the success of the transition. And it will help market the change effort by showing how the proposed reform, properly controlled, will be less expensive over time than the current system.

For these reasons, and to test the assumptions reflected in the figure on page ten of this report, we developed the analysis that appears below.

We wanted to determine if system reform, even after taking into account transition costs incurred in early years, resulted in a lower total cost to the agency over a ten-year time period. To do so, we conducted a retrospective look at the transition costs incurred in Broward County, Florida's juvenile detention system. Using available Broward County data, we made what we regard as well-grounded assumptions about future use of the current system and alternative approaches in order to arrive at cost estimates in nominal dollars for operating the system, the rate at which operating costs would escalate over time, and a figure to calculate the net present value of expenditures in later years (using roughly the interest rate at which the state would have issued ten-year bonds).

In the chart, we have outlined simplified cash flows for three avenues a county or state might take in providing detention services. They are: (1) continue with the old system mix, locking most juvenile offenders in secure detention and, as the center bulges in overcapacity, adding new beds; (2) wait until a law suit is brought against the county or state and then make the switch to a mixed system with both secure and non-secure detention -- essentially a reactive posture; or (3) make a proactive decision to provide non-secure alternatives in place of secure detention for lower-risk youth, while continuing to provide secure detention for high-risk youth.

We then created a spreadsheet using Broward County's financial figures to provide an analysis of these three options. Of course, since all cash flow is negative because they are expenditures, the best option is the one that costs the least. The NPV of the three options is calculated. The least expensive avenue is Option C -- a proactive change of system mix to more alternatives.

The chart which follows portrays this ten-year cash flow projection. Option A -- continuing the old system -- has a large initial cost as new capacity is added on and a linear ascending slope as costs are added. Option B -- waiting for the lawsuit before changing -- entails the lowest initial costs, but the transition costs are the largest and are spread out over three fiscal years; once the transition is completed, there are ongoing increasing costs but at a much lower level than in Option A. Option C -- the proactive transition -- shows an immediate but smaller transition cost over only two years with several years of additional cost savings until year seven when ongoing costs reach the level of expenditures in Option B.

Using this projection of cash flows and considering the net present valuations, it becomes obvious that a proactive transition stands out as the best financial choice over the long-term.

The spreadsheet which we used to arrive at this chart listed the various types of costs associated with a system transition. This sort of spreadsheet, and list, can function as a budget planning tool, for jurisdictions preparing to convert from a secure system to one with a variety of non-secure alternatives. Specific costs will vary from system to system; our list serves as a guide to costs which, in some systems, may not be explicit in the budget process.

A multi-year projection must divide both expenses and revenues into those that are designated for ongoing operations and those that are designated for transition. The list of expenses must cover both the old and new systems as well. Thus, our list of expenses for Broward County included costs of operating the detention facility such as wages, food, transportation and utilities, and capital costs such as construction, renovations and equipment. Our list of expenses

also included operating costs of alternatives to the detention facility, such as costs of contracts with shelter providers and day program operators.

Our list of transition costs for Broward County suggests the level of detail necessary for projecting transitional costs. We included the following:

- 1) Project planning:
 - mediator for litigation
 - county/state staff time
 - overtime
 - project coordinator
 - travel
 - operational expenses
- 2) Development of Risk Assessment Tool:
 - county/state staff time
 - consultants

 - travel
 - operational expenses
- 3) Legislative Task Force:
 - county/state staff time
 - consultants
 - lobbyist
 - travel
 - operational expenses
- 4) Advocacy in Courts, Community:
 - county/state staff time
 - consultants
 - advisors
 - attorney fees
 - operational expenses
- 5) Developing Alternatives to Secure Detention:
 - county/state staff time
 - consultants
 - purchase/rentals
 - travel

operational expenses

- 6) Developing a System for Tracking and Evaluation:
 - county/state staff time
 - consultants
 - hardware/software
 - training
 - travel
 - operational expenses
- 7) Training Constituencies for New System Mix:
 - county/state staff time
 - other personnel
 - consultants
 - training
 - travel
 - operational expenses
- 8) Marketing the New System:
 - county/state staff time
 - consultants
 - public relations expenses
 - operational expenses

Net Present Valuation of Three Options Using Broward County Data

Assumptions:

- 4.5% Growth Rate
- 7% Rate of Return for investment purposes
- Ten Year Term
- No Depreciation, No Salvage of Capital
- Alternatives grow at 10% first three years.
- When alternative are brought on line, secure costs decline by 15 percent the second year and then begin to grow
- Continuing the old system assumes adding secure capacity
- Additional secure soft bed operating cost of \$10,000
- Population is controlled in the secure detention system.

A. Continue Old System, No Law Suit, additional capacity added out of operating budget.										
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Ongoing Operating Costs	2,805,952	2,932,220	3,064,170	3,202,057	3,346,150	3,496,727	3,654,079	3,818,513	3,990,346	4,169,912
Build 40 soft beds	1,200,000									
Additional Operating Costs		400,000	418,000	436,810	456,466	477,007	498,473	520,904	544,345	568,840
TOTAL	4,005,952	3,332,220	3,482,170	3,638,867	3,802,616	3,973,734	4,152,552	4,339,417	4,534,691	4,738,752
NPV: \$29,008,205										
										B. Continue Old System, Law Suit Wins, Change System Mix (Broward example)

APPENDIX B

System Reform -- Finance-Related Issues

As we explored the potential of using alternative financing mechanisms to fund system transitions, many questions were raised regarding applications of those mechanisms, particularly debt financing. Chief among these was a concern over using alternative financing to take "off budget" programs and services that must be funded from the operating budget. While a legitimate issue, the alternative financing approaches under consideration would be strictly limited to financing one-time transition costs, that is, those non-recurring expenses related to phasing out certain services while simultaneously phasing in new, less costly ones. Thus, built into this inherently fiscally conservative approach is the requirement that existing and freed-up revenue sources be adequate to fund all new services (and hopefully actually generate savings over time).

A second frequently raised concern was that debt financing must be limited to "bricks and mortar" projects. Our finding is that statutes and custom vary from state to state. In some cases, where statutes do not limit the use of debt, custom is the limiting factor. However, with the movement to "re-invent" government in full flower, the need to find flexible conversion financing may challenge such customs. Thus the need for more research into "transition costs," and for demonstration projects employing alternative financing, to develop a body of knowledge and experience around alternative financing techniques.

Beyond these broad issues raised by numerous respondents, more specific and technical questions have been raised regarding the possible use of bonds as an alternative financing mechanism. The following discussion is drawn from an early day-long review held with a variety of experts in the field of public sector financing, including bond counsel and underwriters, representatives of rating agencies, municipal finance experts, academics, state budget officers, legislators and consultants.

The exploration of the use of medium to long-term debt to finance the transition costs involved in system reform focuses on three issues: 1) purpose, 2) prudence, and 3) credit.

1. PURPOSE: May debt *legally* be issued to pay for some or all of the array of transition related expenses?
 - Legal requirements will vary from state to state. Answers to the "purpose" question will depend on constitutional and statutory provisions regarding permissible uses, volume of debt, and the powers of special purpose authorities.
 - The arbiter of legal purpose is bond counsel, whose opinion that the debt is a lawful obligation of the issuer is a condition of the purchase of the bonds by an underwriter as well as the issuance of a rating by a rating agency.
 - Historically, state constitutions and laws limited long term debt issues to pay for physical assets with a measurable useful life. The volume of general obligation debt most often is subject to a ceiling or tied to tax revenues. The volume of revenue debt most often is not limited.
 - The modern trend has been to evade limitations by forming agencies not subject to them, and, over time, to liberalize "public purpose" requirements. One example of the latter is, in one state, the statutorily authorized use of long-term debt to pay for the cost of periodic real estate tax reassessments. The cost of reassessment is, of course, assumed to yield additional real estate taxes each year more than sufficient to cover the debt service. The trend has not yet extended to "prevention" expenditures, whose aim is the avoidance of future social costs (e.g., immunizations, Head Start teachers' salaries, employment training programs).
 - For all practical purposes, the issue of payment for "soft costs" involved in system reform will have to be addressed on a state-by-state basis.

2. PRUDENCE: As a matter of budget policy, would it be *wise* to issue debt for this purpose, rather than paying for the expenses out of annual appropriations?
- Long-term debt is used when there is a desire to match benefits from an expenditure with the burden of paying for that expenditure. The key question here is whether, assuming the "public purpose" hurdle has been overcome, it can be concluded that quantifiable long-term benefits will in fact result.
 - The first arbiter of prudence is the budget officer. Projected long-term benefits from the debt issue, which would justify shifting costs to taxpayers in later years, in order of decreasing attractiveness, are:
 - ▶ Avoided capital costs -- these are relatively easy to quantify, and are often a large number;
 - ▶ Increased revenues whose collection and redeployment can be controlled (but may diminish if there are changes in federal policy or the behavior of other third party payors);
 - ▶ Net operating cost avoidance over time -- predictability is less certain (may suffer due to population shifts, shifts between systems, net widening and changes in federal policy); and
 - ▶ Improvement of service with better outcomes -- here the economic benefits are not readily quantifiable.
 - Using long-term debt can also be seen as a way of avoiding a vote on a tax increase that would otherwise be needed to pay for proposed expenditures. While this may be good policy at times, it is also an approach that is subject to abuse (*e.g.*, New York City's experience in the 1970s).

- The bond rating agency is the other gatekeeper. The agency will be concerned that the issuer may be:
 - ▶ Trying to defer payment of expenses that have historically been dealt with through the operating budget; or
 - ▶ Not sufficiently realistic about economic benefits, either overestimating increased revenues or, especially, net operating cost avoidance.

If debt is a general obligation of the issuer, the agency is less concerned about inquiring into the soundness of the economic projections -- unless the issuer has had a recent history of budget difficulties (*e.g.*, Philadelphia in the early 1990s).

If the debt is a revenue obligation of the issuer -- limited to the receipt of revenues and other dedicated funding streams -- there will be real concern about the soundness of the projections. Historically, rating agencies have not regarded projected avoided costs as a source of funds to repay debt. A challenge will be to structure a transaction in such a way that avoided costs, or at least a rough estimate of them, are made available for debt repayment.

3. CREDIT: Will the financial markets *accept* the debt proposed to be issued for this purpose?
 - Purchasers of debt instruments and rating agencies will want to know whether a process or system is in place to "assure" that funds will be available to meet the annual debt service requirements. The purchasers' analysis of the risk involved will be reflected in the interest rate to be paid, and ultimately in the total cash outflow (annually and over time) needed to service the debt.

- Least attractive is a situation where repayment of the debt is conditioned upon annual appropriations by the legislature. Within this category the "essentiality" of the service will influence the purchaser's estimate of the risk involved.
- More attractive is a situation where there is a legislatively approved multi-year plan and a dedicated stream of revenues available to repay the debt service.
- Variations on debt financing would all have to address a number of "technical" legal and practical problems:
 - ▶ specific legislative authorization or other action that satisfies bond counsel;
 - ▶ federal securities law limitations on ability to issue debt to form a "blind pool," *i.e.*, specific purposes not identified in advance;
 - ▶ IRS arbitrage requirements regarding use of proceeds pending disbursement for working capital purposes;
 - ▶ the possibility of obtaining funds piecemeal from existing vehicles, *e.g.*, equipment financing authorities for MIS needs; or
 - ▶ cost involved in starting up a productivity fund.
- Rating agencies are reluctant to place a value on projected net operating cost savings as opposed to new revenue streams. Debt can be made more attractive to purchasers and rating agencies through such credit enhancement devices as insurance and letters of credit. Insurers, however, have the same reluctance to value projected cost savings.

Financial experts consulted for this report noted a number of constraints and barriers to accessing the bond markets to pay for system transition costs. However, many also noted that, in cases where the above conditions could be met and where effective political

leadership was present to promote reform, the barriers could usually be overcome. Key representatives from the private sector expressed a keenness to be further involved in the development of such an innovative financing mechanism.

THE CONSERVATION COMPANY

The Conservation Company is a management consulting firm which provides program development, program assessment, strategic planning, executive search and related consulting services to grantmakers, nonprofit organizations and public agencies. The firm, founded in 1981, has offices in both Philadelphia and New York City. From its inception, the firm has focused much of its efforts on creating innovative and effective public programs, or strengthening existing initiatives. We frequently work across sectors, bringing together private foundations, corporations, nonprofits and state and local governments to promote significant change and reform. Some of the firm's work in recent years has involved the development of elementary school-based health clinics as a means of linking health care and education, leading to better outcomes for children; helping to create a dialogue between grantmakers and public policymakers, with the goal of increased collaboration between the sectors; fostering the replication of proven social programs among both public and private sector funders and program operators, to end wasteful duplication of services and help communities find solutions to pressing problems; and developing new approaches to financing system change at the local level.

JUVENILE LAW CENTER

Juvenile Law Center (JLC) is a Pennsylvania-based public interest law firm that works to reform state systems that serve children. JLC's areas of focus include juvenile justice, child welfare, children's health, and children's mental health. Since 1975, JLC has worked to promote family and community-based services; improve conditions in out-of-home care; ensure children's access to quality health care; guarantee due process from systems that serve children and families; promote children's right to treatment; and reduce barriers to services by enhancing access to services from multiple systems. To accomplish these goals, the Center uses a wide range of strategies, including representing individual children, bringing law reform litigation, doing legislative advocacy, publishing a variety of materials on children and the law, and training professionals and others around the country.