

Aggregating Impact:

A Funder's Guide to Mission Investment Intermediaries

November 2007

Sarah Cooch and
Mark Kramer



FSG  **SOCIAL IMPACT ADVISORS**

FUNDED BY



About FSG Social Impact Advisors

FSG Social Impact Advisors is a nonprofit organization that works with foundations, corporations, governments, and nonprofits to accelerate the pace of social progress through consulting projects, research, and other initiatives.

With offices in Boston, San Francisco, Seattle, and Geneva, our international team of full-time consultants combines the highest standards of strategy consulting with a deep understanding of philanthropy and the nonprofit sector. We invest heavily in research to learn and to develop new ideas, and our thinking is regularly featured in such publications as *Harvard Business Review*, *Stanford Social Innovation Review*, and *The Chronicle of Philanthropy*.

Mission investing by foundations is an approach that FSG believes can have important social benefits. This study is one component of a multi-year FSG initiative devoted to helping foundations better understand and utilize this important philanthropic approach.

For more information, please visit www.fsg-impact.org.

About Surdna

Surdna is a family foundation established in 1917 by John Emory Andrus. The foundation makes grants in the areas of environment, community revitalization, effective citizenry, the arts and the nonprofit sector; with annual grantmaking of approximately \$37 million.

Acknowledgments

FSG Social Impact Advisors gratefully acknowledges the financial support and guidance of the Surdna Foundation, without which this report would not have been possible.

We also thank Anne Habiby for her research assistance and perspective on investment intermediaries addressing urban economic development and affordable housing. Finally, we are grateful for insight and assistance from the following people who served as reviewers of this report:

- Shari Berenbach, Executive Director, Calvert Foundation
- Steven Godeke, Principal, Godeke Consulting
- Luther M. Ragin Jr., Vice President, Investments, F.B. Heron Foundation

Disclaimer

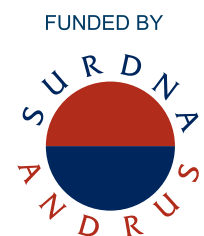
All statements and conclusions, unless specifically attributed to another source, are those of the authors and do not necessarily reflect those of the Surdna Foundation or foundations included in this study.

Aggregating Impact:

A Funder's Guide to Mission Investment Intermediaries

November 2007

Sarah Cooch and
Mark Kramer



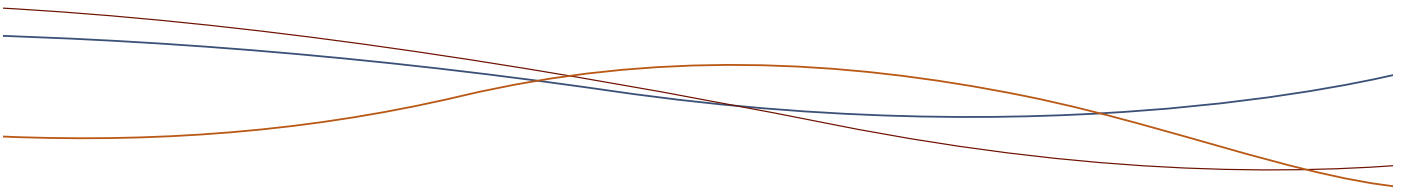


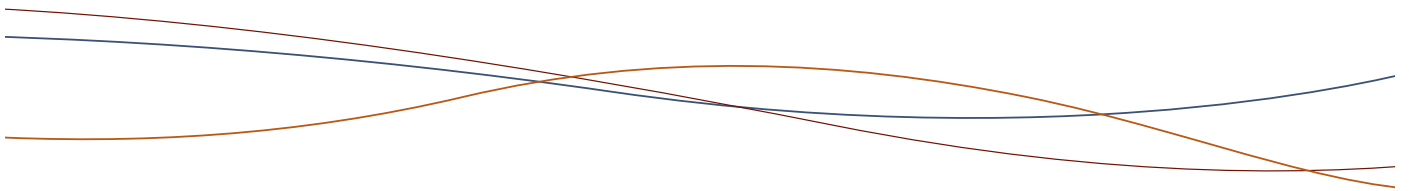
TABLE OF CONTENTS

Executive Summary	4
Mission Investing Through Intermediaries	8
The Advantages and Challenges of Using Intermediaries	18
Investment Intermediary Opportunities	28
Expanding the Reach of Mission Investment Intermediaries	38
Conclusion	40
Appendix	42
Sources Used	
Additional Resources	
Defining Mission Investment Terminology	
Sidebars	
What is Mission Investing?	
Investment Intermediary Data Sources	
Social Investment Terminology	
Aligning Values and Profits	
Community Development Financial Institutions (CDFIs)	
Boston Community Capital and City Fresh Foods: Leveraging Intermediary Expertise	
ShoreBank: Attracting Multi-source Capital	
Community Reinvestment Fund: Securitizing Community Development Loans	
Minority-led and Minority-focused Intermediaries	
Calvert Community Investment Notes	
Kentucky Highlands Corporation: Rural Economic Development	
Coastal Enterprises	
Sea Change: Leveraging Market Forces to Support Sustainable Fishing	
Enterprise Community Partners: Scaling Housing Development	
Root Capital: Extending Successful Intermediaries into New Regions	

For a database of more than 1,000 mission investment intermediaries in economic development, housing, and the environment, organized by field and geographical focus, please see the online supplement compiled by FSG at <http://www.fsg-impact.org/app/content/ideas/item/545>.

EXECUTIVE SUMMARY

Mission investment intermediaries are an effective but greatly under-utilized vehicle for achieving both social and financial returns.



Executive Summary

A new set of tools is emerging to address social and environmental challenges. In addition to grants and contributions, philanthropic foundations and other funders are increasingly using loans, guarantees, venture capital investments, and other financial instruments to advance their missions. These *mission investments* can be used to complement their grantmaking strategies while also replenishing their capital or earning a financial return. Many of these funders invest directly in their grantees or other enterprises that create social impact, but a growing number are beginning to use *mission investment intermediaries*, organizations that collect capital from multiple sources and reinvest it in people and enterprises, whether nonprofit or for-profit, that deliver both social impact and financial returns.

Mission investment intermediaries offer a number of advantages, such as ease of investment, reduced risk, lower transaction costs, specialized expertise, performance reporting, and an expanded deal flow. Often, they also provide their investees with technical assistance or access to additional sources of capital. Yet our research disclosed that many funders are unaware of the wide range of mission investment intermediaries that are available and of the advantages they can offer.

The online supplement to this report includes a database of more than 1,000 mission investment intermediaries

FSG Social Impact Advisors has therefore undertaken this study, funded by the Surdna Foundation, to provide foundations and other funders with an understanding of:

- Current trends in the use of mission investment intermediaries by U.S. foundations
- The range of intermediaries currently available in the areas of economic development, housing, and the environment – as well as the existing gaps in coverage
- Key considerations about how and when to invest through intermediaries
- Opportunities for funders to advance their own missions by creating new intermediaries, or new funds at existing intermediaries

The online supplement to this report includes a database of more than 1,000 mission investment intermediaries in the areas of economic development, housing, and the environment, organized by field and geographical focus, to assist funders that may be interested in specific investment opportunities that align with their interests.

Findings

- Approximately one-third of the U.S. foundations active in mission investing have collectively invested more than \$521 million in intermediaries, and the percentage of mission investment dollars going to intermediaries has been increasing. From 2001 to 2005, one-quarter of all mission investment dollars went to intermediaries.
- Approximately 13 percent of these assets were invested for market-rate returns, ranging from the modest market rate returns of Certificates of Deposit to the more aggressive returns of venture capital funds.
- Mission investment intermediaries generally fall into one of six categories:
 - Community Development Banks and Credit Unions
 - Loan Funds
 - Venture Capital and Private Equity Funds
 - Fixed Income funds
 - Real Estate Funds
 - Public Equity Mutual Funds (also known as Socially Responsible Investment or SRI Funds)
- Among the foundations studied that invested in intermediaries from 2002 to 2005, 57 percent of the capital was invested in loan funds, 26 percent in venture capital or private equity funds, and only 5 percent in SRI Funds.
- Our research disclosed six primary benefits to the use of investment intermediaries.
 - Accessing specialized expertise to improve performance
 - Lowering transaction costs through economies of scale
 - Reducing financial and reputational risk
 - Leveraging tax credits and non-philanthropic capital
 - Broadening the pipeline of potential investments
 - Consolidated reporting of financial and social performance

- Of the 1,030 intermediaries we identified, 78 percent focus on economic development, 56 percent on housing and 9 percent on the environment.¹

Of the 1,030 intermediaries we identified, 78 percent focus on economic development, 56 percent on housing and 9 percent on the environment.

- These intermediaries have an uneven geographical concentration:
 - Economic development intermediaries, most often loan funds, credit unions, and banks, tend to focus regionally and are represented in nearly every state, with the highest concentrations in New York and Pennsylvania.
 - Though fewer in number than economic development intermediaries, housing intermediaries have similar distribution in type and geographic coverage.
 - Most environmental intermediaries that we identified are national, and a majority of them are screened public equity (SRI) funds that consider environmental impact along with a number of other criteria in selecting their portfolio companies. Out of the 1,030 intermediaries in our database, only 13 have an exclusively environmental focus.

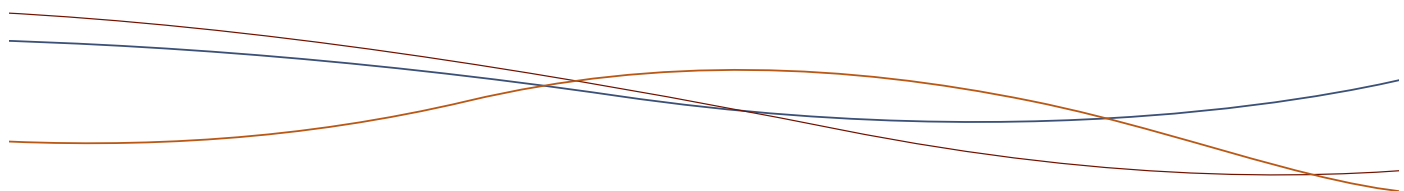
Foundations have been key players in the formation of new intermediaries.

- Apart from the SRI funds, most environmental intermediaries are concentrated in the West and Northwest, in contrast to the housing and economic development intermediaries concentrated in the East and Midwest.

- Foundations have been key players in the formation of new intermediaries, combining their resources with an experienced investment management team to assemble pools of capital dedicated to addressing specific social issues in their regions. Given the many gaps in coverage this study revealed, there appears to be considerable opportunity for foundations to leverage their funds further by creating additional intermediaries or new products at existing intermediaries.

Conclusions

- Mission investment intermediaries are an effective but greatly under-utilized vehicle for achieving both social and financial returns. In many cases, intermediaries can offer funders greater efficiency along with the opportunity to leverage their funds in ways not possible with direct investments.
- There exists a much more robust range of mission investment intermediaries than most foundations are aware of, but the lack of easy access to a comprehensive directory or analysis of these intermediaries represents a significant barrier to increased investment. Information sources do exist but typically do not provide data on the full range of intermediary types.
- In previous research by FSG, foundation leaders described the primary limitation on mission investing as a lack of internal staff capacity. Foundations are usually leanly staffed to make grants and to oversee external investment advisors. Very few have the internal processes or the external relationships to source, structure, and manage a complex portfolio of mission investments. Mission investment intermediaries enable funders to overcome these barriers, using investments to further their missions without adding numerous staff or significantly restructuring their internal processes.



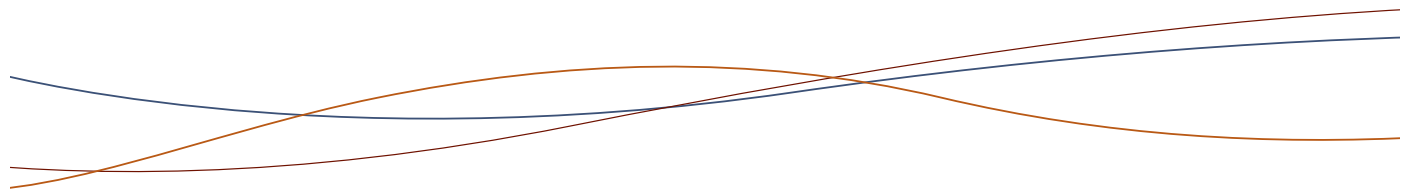
¹ Figures total more than 100 percent because 441 intermediaries address two or more issues.

Mission investment intermediaries enable funders to overcome these barriers, using investments to further their missions without adding numerous staff or significantly restructuring their internal processes.

- The question of whether to invest through an intermediary is a choice that each funder must make based on its own circumstances and objectives, however, there are several key factors to be considered:
 - Does the funder have sufficient staffing to source and manage mission investments internally?
 - Is there a staff member or internal committee that combines the necessary program, legal and investment expertise?
 - Does the funder intend to invest in organizations other than its grantees or to make investments other than loans?
 - Is there a desire to reduce risk through diversification, maintain liquidity, invest a large amount of money quickly, or achieve market-rate returns?
 - Can additional capital be leveraged to address a social issue by using tax credits or bringing in other investors?
 - Would the investee benefit from technical assistance, relationships, or other services that an intermediary might provide?

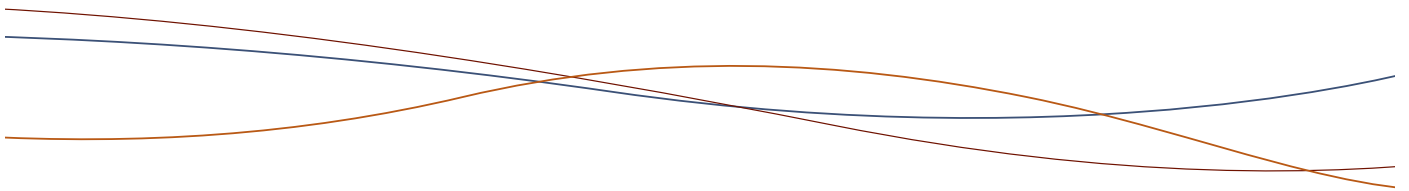
- Our research suggests that many funders could increase the efficiency and effectiveness of their mission investing by utilizing the wide range of intermediaries that currently exist. In addition, when no intermediary is focused on the region or issue of interest, funders have a powerful but often overlooked opportunity to leverage their impact by assisting in the creation of new intermediaries or new product offerings from existing intermediaries. Creating new intermediaries not only enables the initiating funder to invest more easily, but can also attract additional funds, leverage conventional investment capital, and subsidize technical assistance for social enterprises.

Creating new intermediaries can also attract additional funds, leverage conventional investment capital, and subsidize technical assistance



MISSION INVESTING THROUGH INTERMEDIARIES

Foundations are increasingly using mission investment intermediaries as an alternative to direct mission investments.



Mission Investing Through Intermediaries

Introduction

Funders across the country are increasingly investing in *mission investment intermediaries*, organizations that collect capital from multiple sources and reinvest it in people and enterprises, whether nonprofit or for-profit, that deliver both social impact and financial returns. These investment intermediaries enable funders to impact multiple organizations with one investment, reducing risk and transaction costs while accessing specialized expertise and a wider spectrum of investment opportunities.

What is Mission Investing?

Mission investing is the practice of making financial investments with the intention of (1) furthering a foundation's mission and (2) recovering the principal invested or earning a financial return.

FSG's research has identified a pronounced trend toward the increased use of mission investments by foundations of all sizes as a means of achieving their programmatic objectives. Mission investments can complement traditional grantmaking, using either program or endowment funds. For more information, see *Compounding Impact: Mission Investing by U.S. Foundations* (2007) at <http://www.fsg-impact.org/app/content/ideas/item/485>. See also Kramer & Cooch, *The Power of Mission Investing*, Stanford Social Innovation Review, Fall 2007.

Some types of mission investment intermediaries have captured mainstream media attention, such as the “green” venture capital and private equity funds that have recently enjoyed a large influx of capital. Most intermediaries, however, carry out

their important work without much fanfare, developing inner cities' economies, working to provide affordable housing, and protecting environmental resources. In 2005 alone, mission investment intermediaries achieved impressive results, such as:

- financing and assisting 9,074 businesses that created or maintained 39,151 jobs;
- facilitating the construction or renovation of 55,242 units of affordable housing;
- building or renovating 613 community facilities in economically disadvantaged communities;
- providing 11,401 alternatives to payday loans; and
- helping 138,045 low-income individuals open their first bank account.²

In general, our research suggests that mission investment intermediaries have achieved sound financial performance and demonstrated substantial social impact on issues in the major program areas of many U.S. foundations. Surprisingly, however, our research also disclosed that less than one-third of the foundations engaged in mission investing have ever used intermediaries.³ In many cases, this is because foundations confine their mission investments to low-interest or no-interest loans to their grantees, while others were simply unaware that intermediaries addressing their targeted issue areas and geographies existed. Although there remain many gaps in coverage by geography and issue, FSG's research has found over 1,000 U.S. investment intermediaries that focus on economic development, affordable housing, or the environment. The supplement to this study, available online at <http://www.fsg-impact.org/app/content/ideas/item/545>, provides a comprehensive database of these intermediaries, organized by issue and regional focus, to assist funders interested in finding specific investment opportunities.

In addition, this study aims to provide funders interested in mission investing with an understanding of:

- What investment intermediaries are and how funders can leverage them to further their program goals.
- When investing through intermediaries is most useful; and
- How funders might encourage the creation of new intermediaries to fill in existing gaps.

² These results were achieved by Community Development Financial Institutions (CDFIs). CDFIs made up the majority of the intermediaries that FSG studied. Data source: Providing Capital, Building Communities, Creating Impact, FY 2005 Data Fifth Edition, The CDFI Data Project, 2006.

³ Based on a sample of 92 U.S. foundations active in mission investing. For details on FSG's mission investment findings beyond the use of investment intermediaries, see *Compounding Impact* by Sarah Cooch and Mark Kramer, www.fsg-impact.org/app/content/ideas/item/485.

Methodology

For this study, we utilized data collected in our comprehensive research with 92 U.S. foundations in 2006. The broad findings of that research are presented in our publication *Compounding Impact: Mission Investing by U.S. Foundations*.⁴ The interviews we held with foundations and the data we collected on their

individual mission investments provides a clear picture of these foundations' current and past usage of investment intermediaries by type and issue area as well as their opinions about this approach. In addition, we analyzed the landscape of existing intermediaries that address economic development, housing and the environment in the United States, using the data sources listed in the sidebar below.

Investment Intermediary Data Sources

- **The CDFI Data Project www.cdfi.org/cdfiproj.asp**
A collaborative initiative to create a data collection and management system that produces data for and about the community development finance field. The CDFI Data Project publishes a periodic study on CDFI performance and activity across the United States and offers a comprehensive database of CDFIs and their activities/performance for purchase.
- **The CDFI Fund www.cdfifund.org**
A program of the U.S. Department of Treasury, the CDFI Fund provides capital and assistance to CDFIs to spur economic revitalization and community development. The Fund's web site offers a searchable database of CDFI Fund award recipients.
- **Community Investing Center www.communityinvest.org**
A project of the Community Investing Program of the Social Investment Forum Foundation and Co-op America. The Center's mission is to provide financial professionals with information and resources to help them channel more money into community investing. This includes "how-to" guidance for investors and a searchable database of CDFIs and other community development investment intermediaries.
- **Community Development Venture Capital Association (CDVCA) www.cdvca.org**
Association of community development venture capital and private equity firms. Offers searchable listing of community development venture capital funds.
- **Social Investment Forum www.socialinvest.org**
The web site of the trade association of the U.S. social investment industry and community. Offers a searchable listing of screened public equity mutual funds.
- **SocialFunds.com www.socialfunds.com**
A web site devoted to social investing, particularly through public equity mutual funds. The site offers a searchable listing of screened public equity mutual funds.
- **Research Initiative on Social Entrepreneurship (RISE) at Columbia Business School www.riseproject.org**
This initiative's web site offers a searchable listing of "double bottom line" investment funds.
- **Calvert Foundation www.calvertfoundation.org**
In addition to operating its own mission investment vehicles, Calvert Foundation provides advice and information about investment intermediary opportunities. The Foundation's web site provides a searchable database of intermediaries, with high level information on each.

⁴ See www.fsg-impact.org/app/content/ideas/item/485.

Mission Investment Intermediaries

Mission investments provide investment capital to individuals, nonprofit organizations and for-profit companies that create positive social or environmental impact. Although mission investments have social goals similar to grants, they are not gifts of money but rather investments made with the expectation of recovering principal or earning a financial return. This investment capital enables recipient organizations to expand and improve their operations and, ultimately, to create more social impact.

For example, a below market-rate loan to a homeless shelter might enable the organization to purchase a building at a lower, set rate instead of paying increasing rent, thereby enabling it to serve more in need. A private equity investment in a fledgling clean energy company could help bring environmentally friendly technology to market. An investment in an affordable housing loan fund can provide critical mortgage money to lower income first time homebuyers. A market-rate deposit at a community development bank can provide capital for local business lending to drive economic development.

FSG's comprehensive research on 92 U.S. foundations active in mission investing revealed that most have made investments directly in organizations in need of capital to fuel their own operations. These *direct mission investments* include:

- Loans or loan guarantees (typically to nonprofit organizations); loans are by far the most common type of direct mission investment
- Private or public equity investments in for-profit companies that achieve social or environmental impact
- Investments in real estate, usually for the use of a nonprofit organization
- Purchase of a bond issued by an organization, company, or government agency

When making a direct investment, a foundation finds the investment opportunity, conducts due diligence on the potential investee, structures the terms of the transaction, manages the investment for its duration, and tracks financial repayment. The difficulty is that most foundations are not adequately staffed to undertake this work. FSG's research found that lack of staff capacity was cited by nearly 40 percent of foundations as the

Social Investment Terminology

Social investing is the general practice of considering social and environmental factors when making investment decisions. Within this broad category, investments that specifically further a funder's mission or program goals are termed **mission investments**. Mission investments can take the form of debt or equity; they can be funded by either program or endowment funds; and they may seek either market-rate or below market-rate financial returns.

Socially responsible investment (SRI) funds are mutual funds of publicly traded securities that are either positively screened to include businesses with socially beneficial practices, or negatively screened to exclude businesses that are viewed as socially detrimental. If the screen is tailored to an investor's mission, then the SRI fund may be considered a mission investment. Investors can also utilize **shareholder advocacy**¹ through their stock holdings to encourage companies to alter their operations. If the issues they advocate for are related to the investor's mission, the investment may be considered a mission investment.

Some foundations use the term **program-related investments** or **PRIs** to refer to all social investments or below market-rate mission investments. Strictly speaking, however, PRIs are defined by a set of guidelines forth in the Internal Revenue Code. If an investment meets these guidelines, then private U.S. foundations may count the PRI toward their annual 5 percent payout requirements. Nearly all PRIs have below market-rate expected financial returns, although IRS regulations do not prohibit market-rate returns if other conditions are met.²

For additional information on Terminology, please see the Appendix to this report.

¹ For more information on shareholder advocacy by Foundations, see *Unlocking the Power of the Proxy by Rockefeller Philanthropy Advisors and As You Sow Foundation, 2004.*

² For more information on PRI guidelines, see www.irs.gov. For more information about PRIs in general, see the *PRI Makers Network Web site: www.primakers.net.*

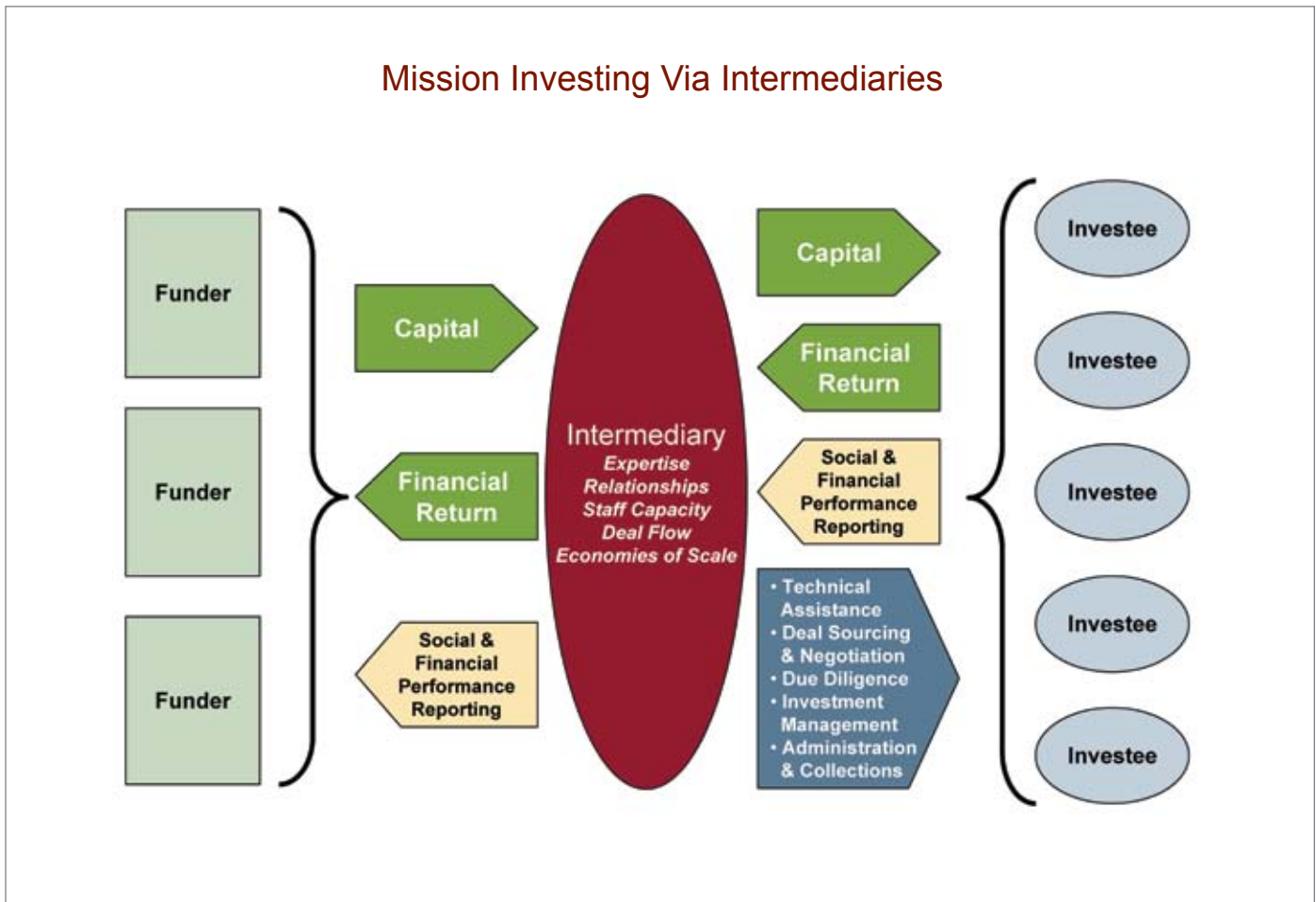
primary reason for limiting mission investment activities. Even when staff capacity is available, it is rare to find the specialized expertise that combines a knowledge of the social issue with an understanding of the necessary financial and legal tools to structure an investment and the external relationships needed to develop a robust deal flow.

Lack of staff capacity was cited by nearly 40 percent of foundations as the primary reason for limiting mission investment activities.

As a result, foundations are increasingly using mission investment intermediaries as an alternative to direct mission investments. Intermediaries typically focus on one issue area (e.g., affordable housing or economic development) and build

specialized portfolios of investee organizations addressing that issue. By placing capital in an investment intermediary, a funder can impact multiple organizations with a single investment.

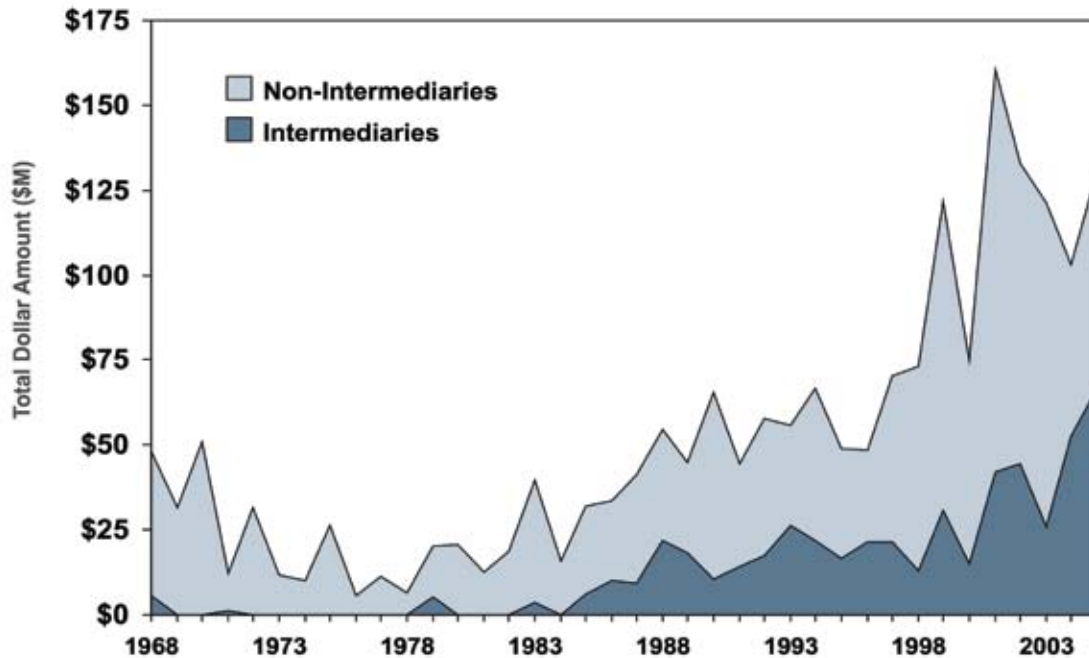
FSG’s research has found significant and growing use of mission investment intermediaries by U.S. foundations. About 30 percent of the 92 foundations active in mission investing in our study have made investments totaling \$521 million into intermediaries.⁵ As more funders engage in mission investing, the use of intermediaries is growing as well. From 2001 to 2005, 25 percent of all dollars committed to mission investments by the foundations in our study went to intermediaries, totaling \$231 million.⁶ Several foundations exclusively utilize intermediaries for their mission investing. *“We knew from the beginning that we didn’t have the time or skills to do this in-house so we chose to use intermediaries. We’re leveraging their expertise,”* said one community foundation CFO.



⁵ In constant 2005 dollars. These investments were made from 1969 to 2005, the time period covered in FSG’s study.

⁶ In constant 2005 dollars.

Annual Dollar Amount Committed To New Mission Investments



Note: In constant 2005 dollars based on annual average CPI, all urban consumers as reported by the US Dept of Labor. To avoid major swings due to periodic large equity investments, one foundation's infrequent and large equity investments are not included in this trend analysis.

Investment Intermediary Types

When making mission investments, funders can choose from a wide spectrum of intermediary types, each offering specialized investment products.

We do not include socially focused asset managers in our definition of mission investment intermediaries because they typically do not maintain a particular issue or regional focus, but tailor their investment strategies to fit the needs of each client.

To be consistent, we also did not include separate accounts, a customized strategy that some foundations use to tailor their real estate, fixed income and public equity investments.

It is important to note that two of these intermediary types, community development banks and community development credit unions, are federally regulated institutions. As a result, they offer insurance on deposits as well as a higher degree of transparency with respect to financial information and an assurance of oversight.

Mission Investment Intermediaries⁷

Intermediary Type	Description	Products Available for Funder Investment
Community Development Banks	For-profit corporations that provide capital to underserved communities through targeted lending and investing. Deposits are insured by the FDIC.	<ul style="list-style-type: none"> • Checking and savings accounts • Certificates of Deposit (CDs) • Money market accounts (combination of short-term, low-yield investments) • Preferred stock equity investments in the bank
Community Development Credit Unions	Nonprofit financial cooperatives owned by their members. Provide financial services to underserved communities. Deposits are usually insured by the National Credit Union Administration.	<ul style="list-style-type: none"> • Certificates of Deposit (CDs) • Preferred stock • Common stock • Secondary capital⁸ (subordinate loan to the credit union that helps build its balance sheet)
Loan Funds	Pools of capital that provide loans and often technical services to targeted organizations. Some loan funds operate in a single geographic region or mission focus while others manage multiple funds or serve as funds of funds. Loan funds are nearly always nonprofit entities.	<ul style="list-style-type: none"> • Senior loan • Subordinated loan (lower priority for repayment than senior loans and helps build the loan fund's balance sheet) • Equity equivalent investment (deeply subordinated loan that helps build the fund's balance sheet)
Venture Capital and Private Equity Funds	Pools of private equity capital that are invested in small to medium size businesses. The fund may focus on helping to develop companies in a specific geographical region or on those that impact a particular social issue, or a combination of both.	<ul style="list-style-type: none"> • Equity investments
Real Estate Funds	Pools of equity real estate investments made for a specific social purpose such as urban revitalization or environmental conservation.	<ul style="list-style-type: none"> • Equity investments
Fixed Income Funds	Pools of fixed-income securities (mortgage- and asset-backed securities, municipal bonds, etc).	<ul style="list-style-type: none"> • Mutual fund investments
Public Equity Mutual Funds	Pools of public equity securities that are selected based on positive or exclusionary screens. Positive screens define which companies can be <u>included</u> (e.g., companies with strong environmental records) while exclusionary screens define which companies should be <u>excluded</u> (e.g., no tobacco companies).	<ul style="list-style-type: none"> • Mutual fund investments

⁷ Adapted from The Community Investing Center. See www.communityinvest.org.

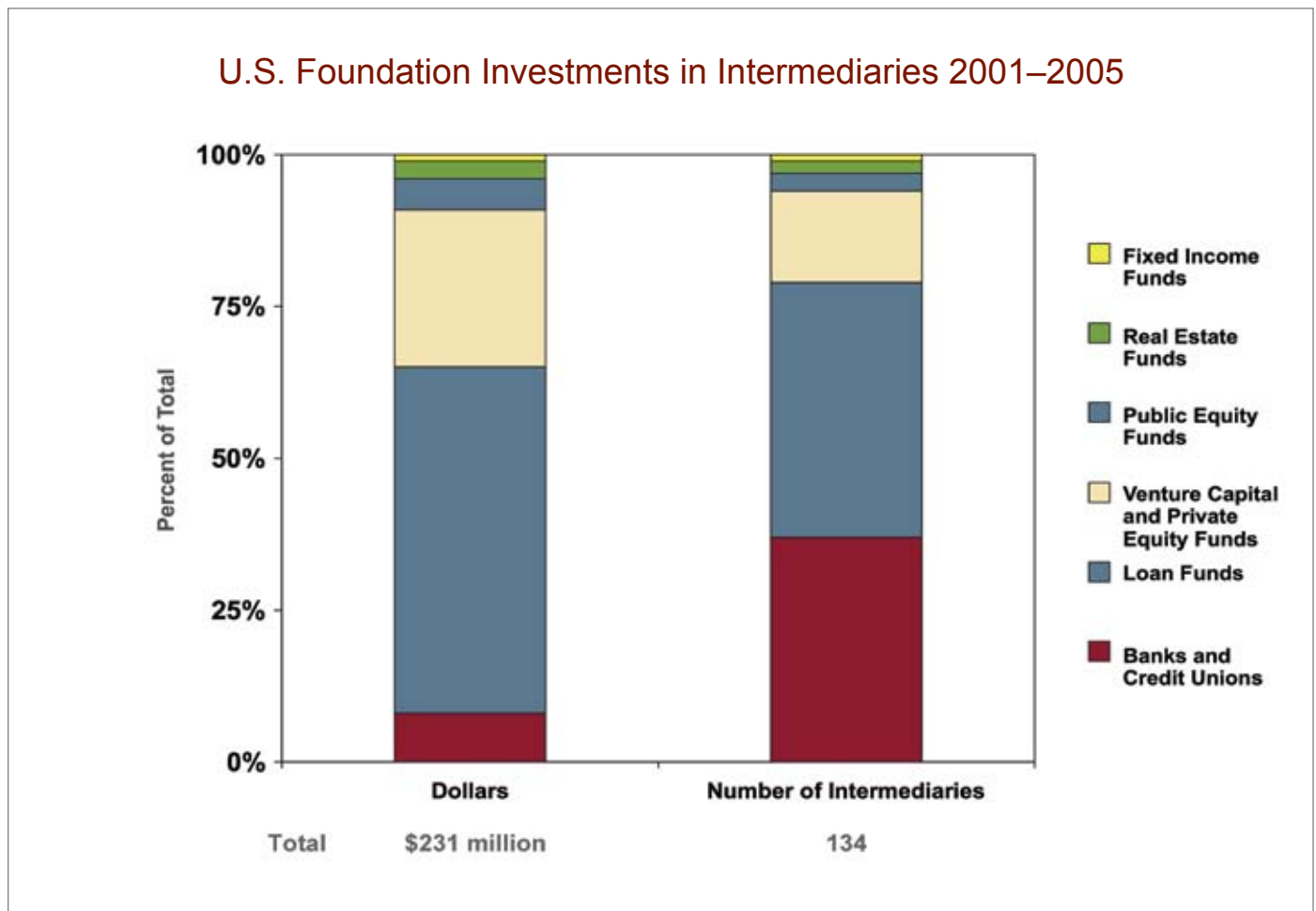
⁸ Only community development credit unions that are classified as "low-income designated credit unions" by the National Credit Union Administration may accept secondary capital.

U.S. Foundation Investment in Intermediaries

During 2001–2005, the foundations in FSG’s study concentrated 57 percent of their intermediary investment dollars in loan funds and 26 percent in venture capital or private equity funds. Community development banks and credit unions accounted for only 8 percent of the total dollars invested. However, because of the small average investment size of \$100,000, they made up 37 percent of the intermediaries by number.⁹ By contrast, the average investments in loan funds and venture capital or private equity funds were much larger at \$1.9 million and \$2.7 million respectively.

The foundations in FSG’s study concentrated 57 percent of their intermediary investment dollars in loan funds and 26 percent in venture capital or private equity funds.

Only 5 percent of the foundations we studied invested in mission-focused public equity mutual funds that utilize positive (inclusionary) or negative (exclusionary) screens. These “socially responsible investment” or “SRI” funds are the most commonly known types of social investments among the general public, yet they seem to attract minimal interest among foundations. Our interviews with foundations indicate that this is due to skepticism about both the financial and social returns of such funds. “We discussed it with our board but they aren’t convinced that it’s truly a market return and it just doesn’t seem very targeted to our foundation’s goals,” explained a private foundation CFO. Although few foundations have invested in SRI funds, some foundations do require their endowment asset managers to apply limited screens for their investing, most commonly the exclusion of tobacco companies. According to the Social Investment Forum, foundations hold 2 to 3 percent of socially screened assets managed for all U.S. institutional investors.¹⁰



⁹ The maximum FDIC insured amount for deposits is \$100,000, so most foundations limit their deposits to this amount.

¹⁰ 2005 Report on Socially Responsible Investing Trends in the United States, Social Investment Forum, January 2006.

Socially or environmentally focused real estate and fixed income funds together captured less than 0.5 percent of the total assets in our study. Mission-oriented fixed income funds are infrequently used, perhaps because such funds are relatively new to the market. For real estate, our interviews with foundations indicate that this relative lack of investment may be due to the lack of mission-related real estate funds that target specific geographies, as well as a reluctance of some foundations to make real estate investments of any type. *“We don’t make any real estate investments, not even investing endowment dollars in traditional real estate funds,”* explained a private foundation CFO. *“We wouldn’t make real estate PRIs either.”*

Of all the investments made in mission investment intermediaries from 2001 through 2005 by the foundations studied, 13 percent had market-rate expected financial returns. Market-rate returns vary widely among different asset classes from the low-risk low-return yield on a federally insured certificate of deposit to the higher-risk, higher-return expectations of private equity and venture capital funds. The market-rate mission investment intermediaries we studied spanned this entire range.

Aligning Values and Profits

A number of foundations are becoming increasingly uncomfortable with the disparity — sometimes even the contradiction — between their missions and the investments in their endowment portfolios. Should a foundation that funds environmental conservation, for example, hold shares in companies that are egregious polluters?

Many of the environmental intermediaries in our research are effective vehicles for screening out such dissonant investments, as are an even broader range of widely available socially responsible investment funds.¹

Of course, some funders hesitate to use social or environmental criteria in managing their endowment portfolios for fear of sacrificing financial returns. Yet a growing number of sophisticated investors are using these very same factors in an effort to enhance their returns.

Abby Joseph Cohen, the internationally renowned Senior U.S. Strategist for Goldman Sachs, for example, claims that sustainability factors are an increasingly important driver of investment returns. The recently launched GS Sustain research division screens companies on environmental, social and governance practices, as well as financial performance, with the express aim of outperforming the market; over the past two years, their selections outperformed the MSCI World Index by 25%.

The UK-based Generation Investment Management, founded in 2004 by David Blood and Al Gore, has achieved similar above market-rate returns. The Generation investment team is convinced that sustainability issues will be a primary driver of industrial and economic change over the next 50 years and therefore must be fully integrated with fundamental equity analysis for superior long-term investment results.

Whether motivated by social conscience or the desire for financial profit, the sustainability issues that investors once ignored are becoming undeniably important factors in the management of endowment investment portfolios.

¹For a directory of socially responsible investment funds see socialinvest.org or socialfunds.com.

Market-rate returns vary widely among different asset classes from the low-risk low-return yield on a federally insured certificate of deposit to the higher-risk, higher-return expectations of private equity and venture capital funds.

Intermediaries providing market-rate returns capture a relatively low portion of mission investment assets for several reasons. First, the vast majority of the foundations we studied have focused on below market-rate mission investments in general and utilize program dollars instead of endowment assets without any expectations of market-rate returns. In addition, some foundations prefer to work with nonprofit intermediaries at below market-rate returns because they can support them through grants as well as mission investments.

Community Development Financial Institutions (CDFIs)

Many existing investment intermediaries are **Community Development Financial Institutions (CDFIs)**, private-sector, market-driven financial intermediaries with community and economic development for low-income people as their primary mission. CDFIs serve market niches that are underserved by traditional financing institutions: 69 percent of CDFI clients are low income, 58 percent are minorities, and 52 percent are women.

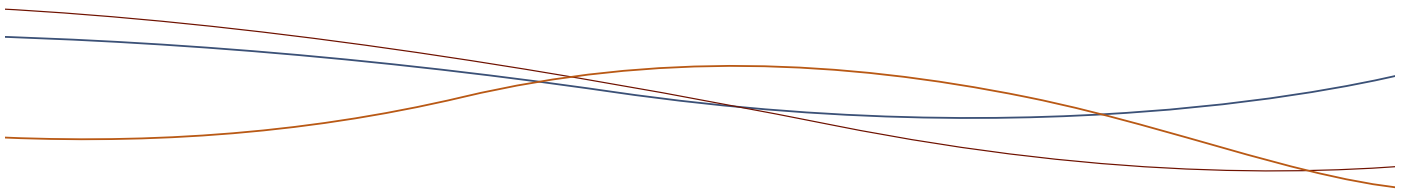
Community Development Financial Institutions began in the early 1900s with depository institutions that collected savings in order to make community loans. These institutions led the way for today's community development banks and credit unions. Starting in the 1960s, community development corporations and loan funds began providing capital to small businesses and affordable housing developers and community development venture funds emerged in the mid 1990s to fuel emerging businesses. Community development banks, credit unions, and loan funds offer relatively safe, low yielding investment options while venture funds represent considerably riskier opportunities.

The creation of the CDFI Fund within the U.S. Department of Treasury in 1994 fueled strong CDFI growth in the 1990s. The CDFI Fund is now one of the largest sources of funding for CDFIs across the country, providing more than \$850 million of capital to CDFIs since its inception. In addition, the CDFI Fund acts as a certifier for CDFIs. In addition, new Community Reinvestment Act (CRA) regulations in 1995 classified investments in CDFIs as qualifying CRA investments, leading to large infusions of capital into CDFIs from commercial banks.

Sources: The CDFI Fund web site, Providing Capital, Building Communities, Creating Impact, FY 2005 Data Fifth Edition, The CDFI Data Project, 2006.

THE ADVANTAGES AND CHALLENGES OF USING INTERMEDIARIES

The use of intermediaries can have tremendous benefits, yet funders must consider the risks and challenges as well.



The Advantages and Challenges of Using Intermediaries

Advantages

There are six key benefits of investing through intermediaries compared to direct mission investments. Some are benefits that accrue to the funder, such as lower transaction costs or reduced risk. Others, such as the access to additional capital or the technical expertise that intermediaries often provide, help to increase the potential social impact that mission investments can achieve.

1. *Accessing specialized expertise to improve performance*

Investment intermediaries are focused on sourcing, assessing, negotiating, and managing financial investments to address targeted social issues. As a result, intermediaries have specialized staff, customized processes, substantial deal flow, and relationships with legal and accounting firms that are all tailored to support these activities. In contrast, most funders do not have staff members that possess the required investment and legal expertise as well as issue area familiarity, nor do they have the external network or internal processes to find, negotiate, and manage direct investments. This is especially true for complex transactions involving tax credits and non-philanthropic investors. *“We only do a couple of investments per year so the learning curve is steep and we never really get in a rhythm,”* admitted one private foundation program officer. A number of foundations use outside consultants to find and structure their mission investments, however it is not always easy to find consultants with the requisite skills, and the transaction costs tend to be higher than using intermediaries.

Intermediaries not only offer investment acumen to foundation investors but many also provide technical expertise to investees on issues such as construction financing, deal structuring, financial auditing, and business development. Executives of intermediaries sometimes take board seats and assist with strategic planning or management

recruiting. They can also be instrumental in attracting other investors for future rounds of funding, including commercial lenders and conventional sources of capital. Most funders would be unable to provide this level of expertise to investees directly, so in some circumstances, the use of intermediaries can actually increase the social impact and, at times, may improve the financial return of a funder’s investment.

2. *Lowering transaction costs through economies of scale*

By investing through intermediaries, funders can outsource much of the time consuming and resource intensive work of finding, conducting due diligence on, structuring, documenting, and managing mission investments. Given the large volume of transactions that intermediaries routinely handle, they can gain far greater economies of scale and higher levels of efficiency than can a funder that makes only a few mission investments each year. A single investment in a capable intermediary can impact multiple investee organizations with far less staff time and lower transaction costs than direct investments in the same number of organizations.

A single investment in a capable intermediary can impact multiple investee organizations with far less staff time and lower transaction costs than direct investments in the same number of organizations.

This benefit addresses one of the major barriers to mission investing that FSG encountered in its interviews with foundations: lack of staff time. *“We just don’t have the staff here to focus on making lots of these investments,”* explained a private foundation. *“They take us more time than grants and we just don’t have the bandwidth.”*

3. Reducing financial and reputational risk

Intermediaries offer funders the opportunity to participate in a diversified pool of investments whose overall performance is usually less volatile than that of a single venture. By contrast, funders that make direct investments often end up with mission investment portfolios that are too small or insufficiently diversified to effectively manage risk.

In addition, intermediaries develop specialized due diligence, technical assistance, and monitoring procedures to minimize the risks associated with specific types of investments they frequently encounter. These processes can yield impressive results: In its periodic research study, the CDFI Data Project¹¹ found that CDFIs in 2005 had a “net charge-off ratio of 0.44 percent, which outperforms the net charge-off ratio of 0.60 percent for all financial institutions in the U.S. Community banks and loan funds had delinquency rates greater than 90 days of only 1.5 percent and 2.4 percent, respectively, and credit unions, which measure delinquency by a different metric, had a delinquency rate greater than 60 days of 1.7 percent.”¹²

Intermediaries develop specialized due diligence, technical assistance, and monitoring procedures to minimize the risks associated with specific types of investments.

Few funders develop the processes necessary to achieve similar results. FSG’s earlier research found that the average default rate on mission investment loans made during 2000 – 2005 was 5.3 percent.¹³

In addition to reducing the risk of nonperformance, investing through intermediaries can reduce the reputational risk for funders if the investment goes poorly. Funders that make direct investments must be prepared for the risk of a publicly reported failure, troubling behavior by the investee, or the negative publicity associated with a large wealthy foundation pursuing

legal remedies to collect on a bad debt or foreclose on the collateral of a struggling nonprofit organization. By investing through an intermediary, funders insulate themselves from such reputational risks.

4. Leveraging tax credits and non-philanthropic capital

Sophisticated investment intermediaries have developed effective approaches to blending technical assistance grants and tax credits with market-rate and below market-rate investments, thereby increasing the pool of available capital by providing different combinations of financial returns to differently motivated investors. The ability to stratify risk and return and to utilize tax credits that have value to taxable investors enables intermediaries to attract substantial capital from investors that might not otherwise be interested in directing their funds toward a particular social or environmental issue. As a result, intermediaries have become adept at attracting a wide range of investors including banks, insurance companies, pension funds, not-for-profits, universities, faith-based organizations, and wealthy individuals.

By providing patient capital, offering technical assistance grants, accepting below market-rate returns, or offering to insulate other investors from the first tier of risk, funders can help intermediaries create investment funds that provide market-rate returns to conventional investors, attracting non-philanthropic capital to address social issues.

In other cases, merely by making the first funds available to a new intermediary, the funder can confer sufficient credibility for that intermediary to successfully raise funds from other sources.

The ability to stratify risk and return and to utilize tax credits that have value to taxable investors enables intermediaries to attract substantial capital from investors that might not otherwise be interested in directing their funds toward a particular social or environmental issue.

¹¹ The CDFI Data Project (CDP) is an industry collaborative that produces data about CDFIs. The CDP collected FY 2005 data on 496 CDFIs and is supported by the Annie E. Casey Foundation, the Ford Foundation, the John D. and Catherine MacArthur Foundation, HSBC Bank U.S.A., Wachovia Foundation, and the W. K. Kellogg Foundation.

¹² Providing Capital, Building Communities, Creating Impact, FY 2005 Data Fifth Edition, The CDFI Data Project, 2006.

¹³ A number of foundations could not easily report the timing or amount of financial returns on their mission investments. The default rate calculation, therefore, is limited to completed loans by foundations that kept adequate records and is not necessarily representative of the larger pool of mission investments. For more information on this research, see *Compounding Impact: Mission Investing by U.S. Foundations* (2007) at <http://www.fsg-impact.org/app/content/ideas/item/545>.

Boston Community Capital and City Fresh Foods: Leveraging Intermediary Expertise

Boston Community Capital was founded in 1985 with a primary mandate to create affordable housing. Since its establishment, BCC has invested more than \$300 million. What it can provide, however, is much more than money.

In 1997 City Fresh Foods approached Boston Community Capital looking for “\$10,000 to get to the end of the week.” City Fresh was founded in 1994 by two African-American brothers in Boston’s inner city community of Roxbury. The company produces prepared foods specializing in authentic Latin, Caribbean, and North American soul food meals that are delivered to seniors through a Meals-on-Wheels contract and to local institutions such as schools. At the time City Fresh approached BCC, the company was providing roughly 450 meals per day, but the company had no assets, no profits, and no cash, and operated from inadequate facilities. As one of the owners stated, “No lender would touch us.”

BCC immediately recognized that a \$10,000 investment was a losing proposition. Instead, they structured a deal of \$190,000 to assist City Fresh in leasing and equipping a much larger space. BCC invested \$130,000 and brought in another partner, the Institute for a Civil Society, to invest \$60,000.

With BCC’s considerable expertise in real estate, BCC secured an agreement with the City of Boston to provide City Fresh with a \$2 per square foot lease and an assurance that any money City Fresh invested in the building would be credited towards a possible future purchase. By 2001, City Fresh was producing 2,500 meals per day, a 550 percent increase, and was able to purchase the building outright.

BCC’s acumen in deal structuring resulted in an appropriate level of capital to grow the company and a very favorable agreement with the City of Boston. Less visible but equally important was the enhanced financial sophistication and operating advice that BCC brought to the company.

After several years of sustained fast growth, in 2006 City Fresh sold 49 percent of its company to Unidine Corporation, a \$50 million food and dining management services. The partnership between the two companies gives Unidine access to City Fresh’s expertise in ethnic meals, while City Fresh gains access to regional and national markets. This next strategic phase would not have been possible without BCC’s early involvement and illustrates the leverage that specialized CDFIs can provide to their funder foundations.

Source: “Boston Community Venture Fund and City Fresh Foods: Engineering An Exit, a case study”, Community Development Venture Capital Association, 2003.

By placing their capital in approved intermediaries that then receive tax credits, funders can augment their investment amount in a way not possible with a direct investment. For example, funders making investments in one of over 200 approved investment intermediaries have seen their funds augmented by New Markets Tax Credits (NMTC). The NMTC Program, the largest federal economic development initiative to be launched in 20 years, was created in 2000¹⁴ to stimulate investment and economic growth in low income urban neighborhoods and rural areas.¹⁵ Some funders have had successful experience investing in NMTC transactions coordinated by community development intermediaries such as the Community Reinvestment Fund, ShoreBank, or Enterprise Community Partners.

The NMTC offers seven-year, 39 percent federal tax credit for Qualified Equity Investments (QEI) made through “Community Development Entities” (CDEs) such as CDFIs. These CDEs use capital derived from the tax credits to make loans to or investments in businesses and projects in low income areas. The NMTC program has \$19.5 billion allocated for tax credits before the end of 2008.¹⁶ As of February 2007, these tax credits have helped to raise over \$7.7 billion in private equity investment targeted to low income communities, including investments by foundations.¹⁷ Even so, there remains a significant opportunity for funders to unlock additional tax credit funds: of the \$19.5 billion allocated for credits before the end of 2008, \$7.4 billion remain available.¹⁸

ShoreBank: Attracting Multi-source Capital

With \$2.1 billion in assets, ShoreBank is America’s first and largest community development and environmental bank. Using funds raised by offering market-rate, federally insured Development Deposits to investors worldwide, ShoreBank provides:

- Residential real estate loans that strengthen communities, provide affordable housing, and build borrowers’ wealth
- Loans to small businesses, faith-based and nonprofit organizations that create jobs and expand community services
- Conservation loans for projects that reduce energy consumption, remediate contamination, or support green business practices
- Bank deposits and retail services

ShoreBank Corporation delivers these services via an array of companies and nonprofit organizations ranging from banks to investment firms to advisory firms. ShoreBank is a full service bank with branches in Chicago, Detroit, and Cleveland, while ShoreBank Pacific is a full service bank serving the Pacific Northwest. Northern Initiatives Affiliated nonprofit organizations such as ShoreBank Enterprise Cleveland focus on local economic development initiatives.

Through its wide range of activities, ShoreBank has developed sophisticated capabilities in working with a range of investors, from foundations to individuals and companies. ShoreBank’s subsidiaries have received over \$35 million in New Markets Tax Credits, millions of dollars in deposits and loans from foundations such as the Ford Foundation and the Knight Foundation, and deposits from companies such as a \$22 million investment from TIAA-CREF.

Sources: www.shorebankcorp.com; www.tiaa-cref.org.

¹⁴ Part of the Community Renewal Tax Relief Act of 2000.

¹⁵ New Markets Tax Credit Fact Sheet, New Markets Tax Credit Coalition, February, 2007.

¹⁶ U.S. General Accounting Office (GAO), Report to Congressional Committees: Tax Policy, January 2007.

¹⁷ New Markets Tax Credit Fact Sheet, New Markets Tax Credit Coalition, February, 2007.

¹⁸ CDFI fund web site.

5. *Broadening the pipeline of potential investments*

Our research found that foundations often make direct mission investments in the form of low-interest or no-interest loans to their existing or past grantees. If they are interested in making other types of mission investments, however, many funders have found it difficult to identify suitable prospects or to establish a consistent and high-quality flow of appropriate deals for consideration. Foundations are in regular contact with grant applicants and conventional investment advisors, but they are rarely in similarly close contact with small businesses, local banks, housing developers, or for-profit enterprises. Not only are they unfamiliar with non-grantee organizations, but even if they had a strong deal flow, most funders would not have the staff available to analyze any large number of potentially complex transactions. *“We know the needs of our local nonprofit organizations but we just don’t know where to start with anything else,”* said a private foundation program officer.

In contrast, CDFIs and other intermediaries have staff dedicated to sourcing deals and often have extensive networks of other CDFIs, banks, and community organizations that can refer potential investment opportunities. By investing in these intermediaries, funders can leverage the intermediaries’ broad relationships and long history in the field to find attractive investment opportunities beyond the limited universe of grantees. Many of the foundations we spoke with in our research expressed interest in mission investing but, like the program officer quoted above, had no idea where to find attractive investment opportunities, nor had the staff time available to seriously investigate any potential deals that came their way. For foundations such as these, the use of intermediaries is an attractive way to begin mission investing, enabling them to gain a broader base of experience that may lead to a richer network of direct investment opportunities later on.

Community Reinvestment Fund: Securitizing Community Development Loans

The Community Reinvestment Fund (CRF) is a nonprofit investment intermediary that operates a secondary market for community development loans, providing vital capital to low- and moderate-income communities across the country. Operating since 1988, CRF purchases the right to repayment from community lenders such as CDFIs, nonprofit organizations, and government agencies. Through private placements, it then sells debt securities that are backed by the loan cash flows or else places loans directly with investors.

Beyond acquiring CRF-issued bonds or investing in their revolving fund, foundations, companies, and individuals can support the organization’s work through grants, sometimes with specific parameters around the geographic area to be supported with the funds.

Source: www.crfusa.org.

6. Consolidated reporting of financial and social performance

As noted earlier, the internal processes most foundations have in place to make grants and supervise outside investment advisors are not well suited to managing a portfolio of direct mission investments. The result, as our research confirmed, is that the majority of foundations engaged in mission investing do not effectively track or report on the social or financial performance of their investments. A few foundations in our study have developed sophisticated databases and tracking mechanisms specifically to monitor the financial performance of their mission investment portfolios, and these systems appear to work well. Most foundations, however, are much less sophisticated and diligent about evaluating financial performance. Hardly any foundations in our study have taken the added step of attempting to measure the social impact of their mission investments.

In contrast, intermediaries manage numerous deals of a similar nature and routinely report performance to their investor base. Most have therefore developed sophisticated and efficient financial performance tracking and reporting mechanisms.

In addition, as intermediaries focus on investing to address particular issue areas, they can develop specialized measures of social impact and identify trends across investments. Very few funders have mission investing portfolios that are large enough to enable them to do this. Intermediaries often report the outputs of their efforts such as the number of loans issued and the units of housing developed, and some are even starting to quantify social impacts as well.

For example, the Community Development Venture Capital Association (CDVCA) recently developed the Measuring Impacts Toolkit with funding from the F.B. Heron Foundation and the Rockefeller Foundation. The toolkit provides community development venture capital firms and other investors focused on economic development with standardized social return metrics for comparison among companies and between investors.¹⁹ Though measuring social impact is challenging for any mission investor, investment intermediaries are often better positioned to develop specialized metrics for their particular type of investments than more generalist funders.

Of course, a foundation must carefully assess individual intermediaries to ascertain whether they provide the particular financial and social performance reporting that it requires. If this is not yet the case, the foundation can work with the intermediary to enhance its reporting, especially if this is done in conjunction with other foundation investors.

Challenges and Risks

As with any approach, there are risks of investing in intermediaries and this approach is not appropriate in all situations. Funders must carefully consider whether the benefits of investing in a particular intermediary outweigh the potential hazards.

1. Risk of misaligned goals

By the very nature of investing through an intermediary instead of making a direct investment, a funder must relinquish control over the selection of and interactions with individual investees. The funder must trust the intermediary to select and manage investees in a way that is aligned with the funder's own mission and culture. Intermediaries must be selected carefully, therefore, to ensure that their target geographies and areas of focus, as well as their investment goals and operating style, are aligned with those of the funder.

2. Less direct contact with investees

Some of the foundation staff we interviewed voiced a strong desire to know and interact directly with their investees, much as they do with their grantees. They expressed concern that investing through intermediaries would make the process less satisfying and more remote. In addition, some program officers were concerned that, because their funds would be pooled with other investors, the foundation would not be able to distinguish its own social impact.

3. Overhead costs

In return for the services they provide, most intermediaries charge investors a management fee. Although these fees are a cost that direct mission investors do not incur, they are usually lower than the cost of staff time that would have been required to directly make and manage the investments facilitated by the intermediary.

¹⁹ CDVCA web site www.cdvca.org.

Minority-led and Minority-focused Intermediaries

Minority-led and minority-focused intermediaries provide foundations focused on improving the lives and economic situations of minorities with a doubly attractive investment opportunity. Not only can foundations apply their capital to address minority economic development and housing, but by investing in these institutions they can also help to build jobs and skills for their minority employees and leaders.

One such example is the Latino Community Credit Union in North Carolina. The LCCU is a community-based and member-owned nonprofit financial institution that provides financial services to the local Latino population and is the first fully bilingual financial institution in the state.

Source: Latino Community Credit Union web site: www.cooperativalatina.org.

When to Invest in Intermediaries

Funders should carefully consider the following criteria to determine whether to utilize intermediaries or make direct mission investments.

Key Considerations in Selecting a Mission Investment Approach		
Consideration	if low	if high
Amount of staff time available to source and manage mission investments	Investment intermediary	Direct investments
Level of staff investment expertise	Investment intermediary	Direct investments
Level of risk tolerance for potential loss of capital	Investment intermediary	Direct investments
Desire to invest in organizations beyond grantees	Direct investments	Investment intermediary
Desire to invest in asset classes beyond direct loans and loan guarantees	Direct investments	Investment intermediary
Desire for market rate financial returns	Direct investments	Investment intermediary

If a funder decides to invest in a mission investment intermediary, the next step is to determine the intermediary type to pursue. Here, there are two types of considerations: social and financial.

Social Considerations:

- **Directness of Impact.** Different intermediaries may offer more or less direct impact on a given issue or region. Investing in an SRI fund of publicly traded equities, for example, is unlikely to have an immediate effect on changing the behavior of global corporations. Providing capital to a venture fund that stimulates inner city enterprises, however, is likely to produce more immediate results.
- **Strategic Fit.** Some investments are more tightly aligned with a funder's program goals than others. Meyer Memorial Trust, for example, an \$800 million foundation in Oregon, has a strong focus on affordable housing. A down payment loan fund for low income home buyers not only achieves a direct impact, but is also closely integrated with the foundation's program strategy. Were the foundation focused instead on education, the loan fund would still achieve direct impact, but would not be as tightly aligned with the foundation's strategy.

Financial Considerations

- **Financial return:** Funders must determine their target expected financial returns, both in absolute terms and in relation to market levels. For example, a deposit at a CDFI

may yield market-rate returns for that asset class but does not yield high returns in absolute terms. In addition, funders must examine the fees and other investment terms to ensure that they are reasonable.

- **Risk:** Each investment type has a different level of inherent risk. For example, an investment in a venture capital firm that invests in early stage companies is much riskier than a federally insured deposit at a CDFI.
- **Liquidity:** Each investment type has an expected investment duration during which funders will be unable to easily withdraw their funds. Funders must consider if or when they may want to access the invested funds for other purposes and choose the type of investment accordingly.
- **Past Performance:** As with any investment, some management teams may be stronger than others, resulting in different levels of risk, return, and liquidity, even within the same type of intermediary. Funders must therefore perform careful due diligence on the management team and track record of each individual intermediary to assess its terms, capabilities, and performance.

These financial considerations must be weighed against the funder's social impact goals. For example, a funder might choose to provide secondary capital to a community development credit union because it offers greater social impact, even though the liquidity is less and the risk greater than other intermediary investments with similar financial returns.

Calvert Community Investment Notes

Calvert Foundation, a nonprofit CDFI, was launched in 1995 with support from the Ford, MacArthur, and Mott Foundations to establish a fund of funds in order to maximize the flow of investment capital to underserved communities. The Calvert Foundation evolved from the success of the community investments of Calvert Group, Ltd., a for-profit investment firm and sponsor of Calvert mutual funds. Though separate organizations, Calvert Group provides technical support, office space, and ongoing credit enhancements to the Foundation.

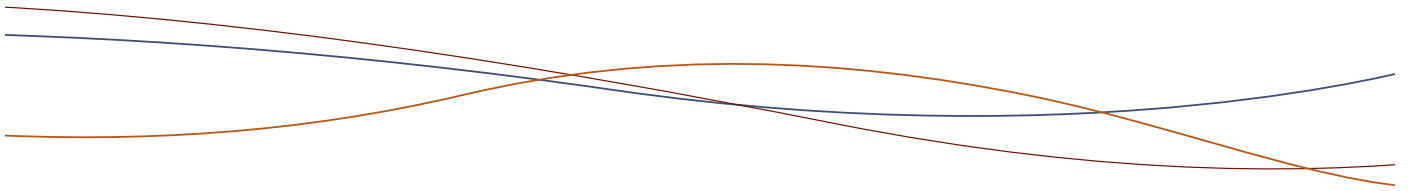
Calvert Foundation offers foundations and individuals several options for community investment. Its flagship product, Calvert Community Investment (CCI) Notes, pools investor funds to provide below market-rate loans to over 200 intermediaries and social enterprises around the world, focusing on affordable housing, microcredit, small business development, community facilities, and social innovations. Though these Notes invest worldwide, foundations that purchase CCI Notes of \$50,000 or more may target their investments to specific geographic or issue areas.

Investors in CCI Notes can choose their terms ranging from 1 to 10 years and interest rates from 0 percent to 3 percent. CCI Notes are liquid and can be redeemed early with a modest penalty that may be waived at the discretion of the Foundation. Though CCI Notes are not federally insured, the borrowers have a 99.8 percent repayment rate and Calvert Foundation has several large investors who hold over \$18 million in long-term investments and guarantees subordinate to CCI Notes, helping to insulate other investors from loss.

Source: Calvert Foundation web site www.calvertfoundation.org; Shari Berenbach, Executive Director of Calvert Foundation.

INVESTMENT INTERMEDIARY OPPORTUNITIES

Our research found over 1,000 investment intermediaries that focus on U.S. economic development, affordable housing, and environment, and operating in every region of the country.



Investment Intermediary Opportunities

Once a funder decides to invest in an intermediary and selects the intermediary type, it must find and conduct due diligence on individual intermediaries that fit selected parameters. Many foundations we spoke to expressed a lack of knowledge about how to find intermediaries relevant to their missions and others believed that no existing options would meet their needs.

To understand this issue, FSG investigated the existing landscape of investment intermediaries that focus on U.S. economic development, affordable housing, and environment. We found 1,030 investment intermediaries representing each intermediary type²⁰ and addressing every region of the country.

Scope of Research

We chose economic development,²¹ affordable housing, and the environment because they are the three most common issue areas addressed by intermediaries in our research with foundations.²² Although we did not study intermediaries that address other issues, we believe that there are far fewer intermediaries outside of the three issue areas we focused on. This suggests that there is considerable opportunity for funders to bring the benefits of mission investment intermediaries into other fields of interest.

We chose economic development, affordable housing, and the environment because they are the three most common issue areas addressed by intermediaries in our research with foundations.

We also excluded from our study a number of important investment intermediaries that direct capital outside the U.S., including a burgeoning number of micro-finance funds and innovative social enterprises such as the Acumen Fund, because more than 95 percent of U.S. foundations' mission investments and 82 percent of their grants stay within the

country.²³ Recently, a significant number of venture capital and private equity funds have begun to invest in clean energy projects or use various social and environmental criteria in selecting companies with the goal of improving their financial returns. These funds may be attractive mission investments for many foundations. However, in order to be consistent with the criteria we applied in housing and economic development, we excluded from our database venture or private equity funds that did not have an explicit social or environmental objective as part of their missions. Finally, we excluded socially-focused asset managers, such as Trillium Asset Management, because they do not maintain a particular issue or regional focus, but tailor their investment strategies to fit the needs of each client.

We compiled data on intermediaries from numerous sources²⁴ available to mission investors, as noted earlier in the Methodology section. We provide a listing of these organizations by issue area addressed and geographic area impacted on our web site (<http://www.fsg-impact.org/app/content/ideas/item/545>) for reference.

Though we hope this listing is helpful to foundations for understanding potential investment opportunities, it is very important to note that when researching these intermediaries:

- We did not conduct due diligence on these firms or funds. Their inclusion in this analysis does not constitute a recommendation to invest.
- We attempted to list the major firms and funds available, but this data set is not exhaustive.
- We did not attempt to ascertain whether these firms or funds are seeking additional investment or have closed to further investment.

Foundations must conduct their own due diligence to ascertain whether it is appropriate to invest in one of these intermediaries.

²⁰ Includes banks, credit unions, loan funds, venture capital/private equity funds, fixed income funds, real estate funds, public equity mutual funds. Numerous community development corporations (CDCs) accept investments from foundations and other private sources to fuel lending in their communities. Some of these CDC's have established formal, stand-alone loan funds while others have lending programs that operate as loan funds, even if they are not officially established as such. In our research, we classified these CDC's as "Loan Funds", whether they had a formal fund established or not.

²¹ Includes business creation/development/expansion/support, microfinance, and job creation.

²² In FSG's study, foundations' investments in intermediaries have focused on economic development (41 percent of all dollars invested in intermediaries) and housing (20 percent). The remaining 39 percent of intermediary investments were spread across a variety of issue areas, with environment receiving 8 percent.

²³ Cooch, Sarah and Kramer, Mark, *Compounding Impact*, FSG Social Impact Advisors, 2007; *International Grantmaking Update*, Foundation Center, October 2006.

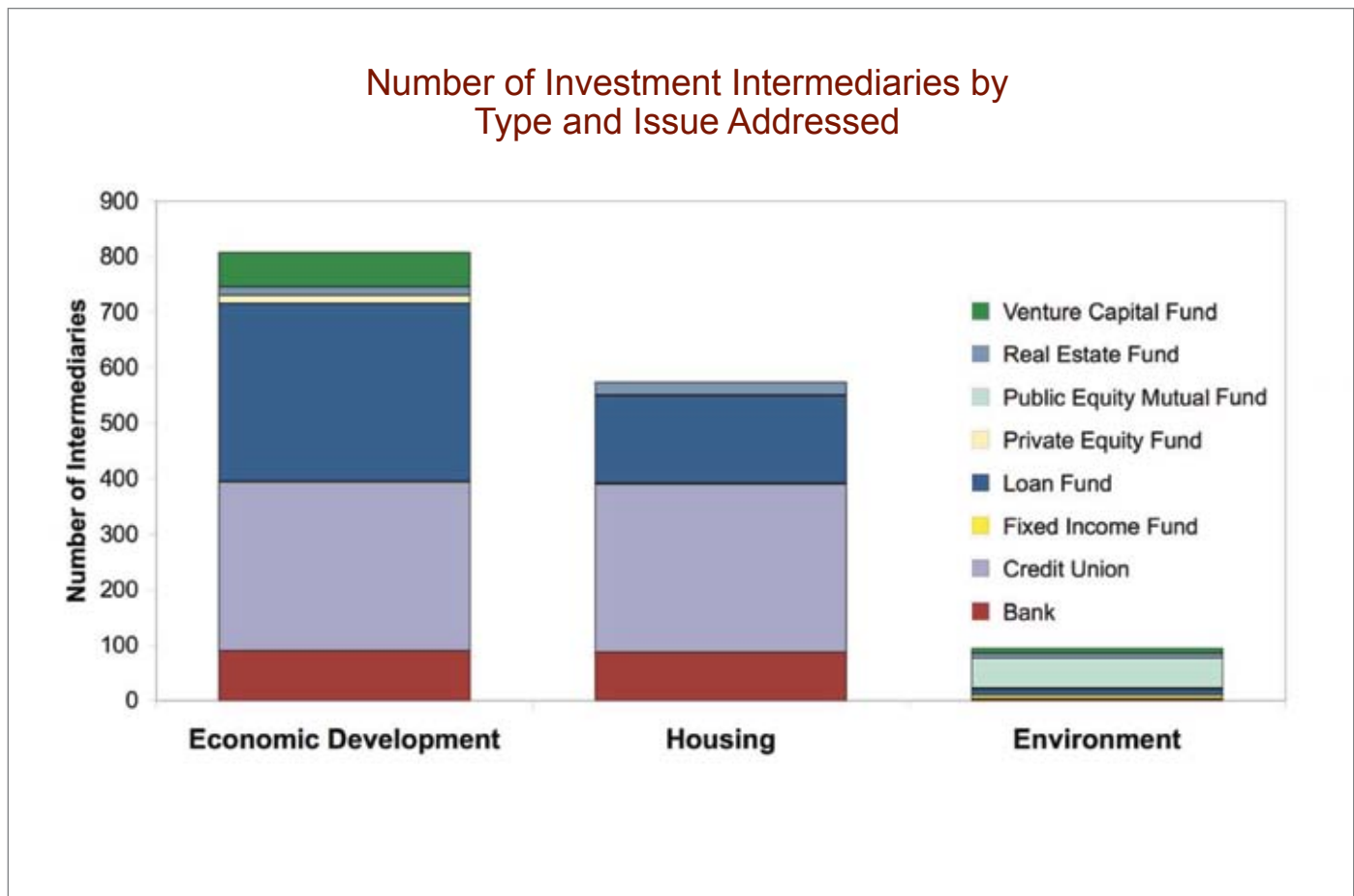
²⁴ Several of the sources we utilized, such as The Community Investing Center and The CDFI Fund, provide summaries of selected intermediaries for investors' use. We encourage funders to visit these sites for more information.

Investment Intermediaries by Issue Area

Seventy-eight percent of the 1,030 investment intermediaries we studied address economic development, including job creation, business development, and financial wealth creation of lower income populations. Fifty-six percent address housing and only percent focus on the environment.²⁵ The concentration in economic development and housing is not surprising given the history of CDFIs in their quest to better the economic situations of lower income communities. In addition, economic development is tightly tied to commercial enterprises and access to capital, making financial investments a natural tool for change. Finally, both economic development and housing have also seen significant bank investment due to Community

Reinvestment Act (CRA) requirements, helping to build relatively large intermediaries.

The distribution of intermediary types addressing each issue area varies considerably. Economic development intermediaries include a high concentration of banks, credit unions, and loan funds, but have also attracted venture capital funds that focus on regional business and job growth. The housing intermediary landscape is dominated by credit unions, banks, and loan funds. In contrast, the environment is served by a different mix of intermediaries altogether, including more screened public equity mutual funds. In fact, all of the screened public equity mutual funds in our study are focused on the environment. We did not find positively screened public equity mutual funds that focus specifically on economic development or housing.



²⁵ Figures total more than 100 percent because 441 intermediaries address two or more issues.

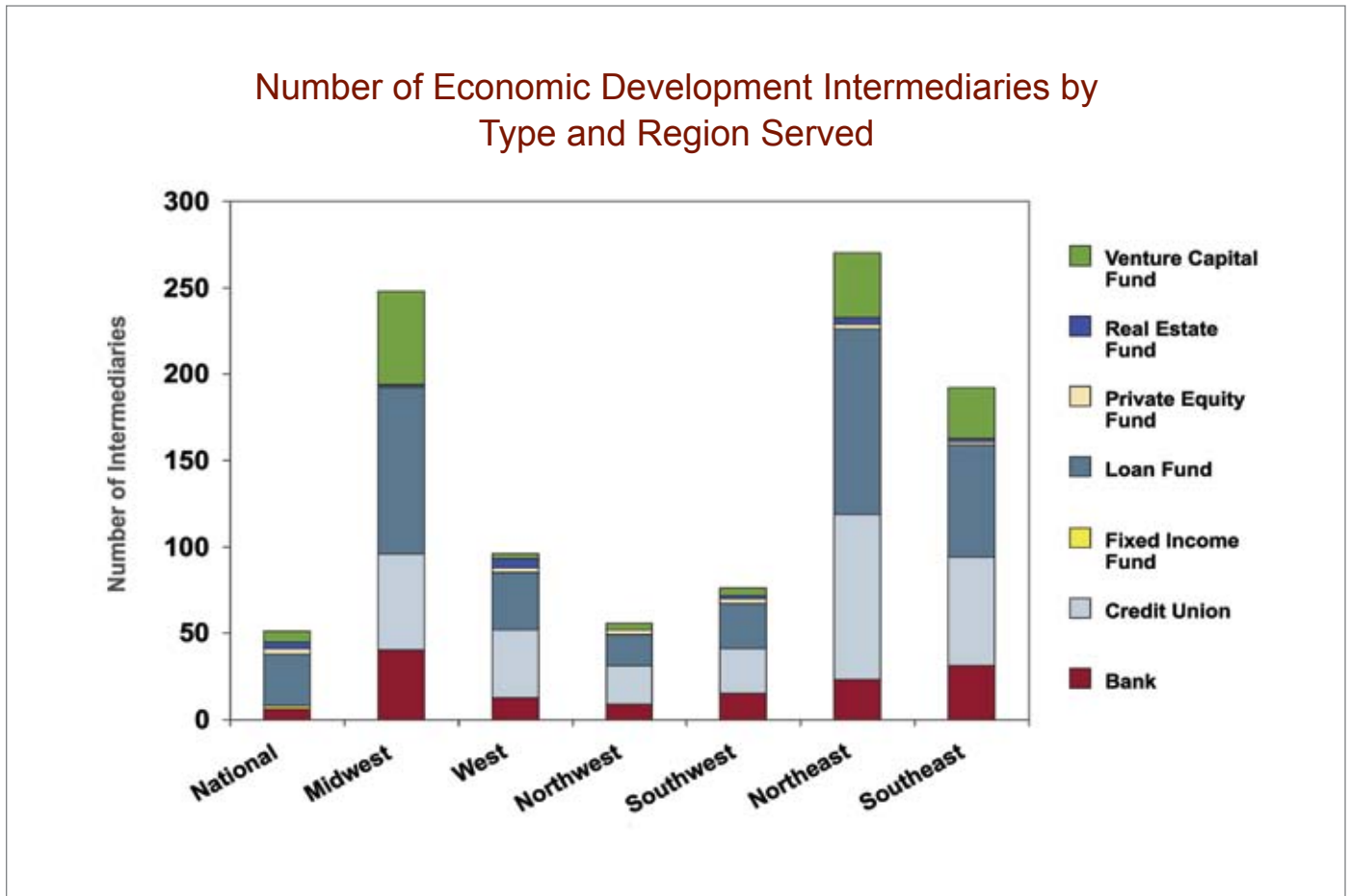
Economic Development

Economic development investment intermediaries serve all regions of the U.S., although the depth of coverage varies widely. Our research found 50 economic development-focused investment intermediaries that invest nationally. However, many of them focus their efforts disproportionately on a few key regions and do not actually serve all 50 states. Funders interested in promoting economic development in a specific region should, therefore, investigate the number of intermediaries that specifically focus on that region.

Although each region of the U.S. has representation from most intermediary types, the distribution is highly uneven across the country. Banks, credit unions, and loan funds are heavily concentrated in New York, California, Pennsylvania, and Texas. Economic development-focused venture capital funds are also unevenly distributed: ten states have five or more locally focused venture capital funds, while a majority of western states have no such funds at all.

The northeast, southeast, and midwest regions have the most intermediaries, while the western half of the United States lags behind, and the northwest region has the fewest intermediaries per state. The northeast's high total is driven by the large number of intermediaries investing in New York (87) and Pennsylvania (52), while other northeast states average only 13 intermediaries. California has the second most economic development intermediaries (58) but the rest of the states in the western region have an average of only 8 intermediaries.

Although we cannot speculate on the historical explanation for these differences or the degree to which foundations may have helped spur the development of intermediaries in different regions, it is clear that the number and types of mission investment intermediaries varies widely from state to state. As a result, funders looking to spur economic development are faced with a disparate range of options depending on their regional emphasis.



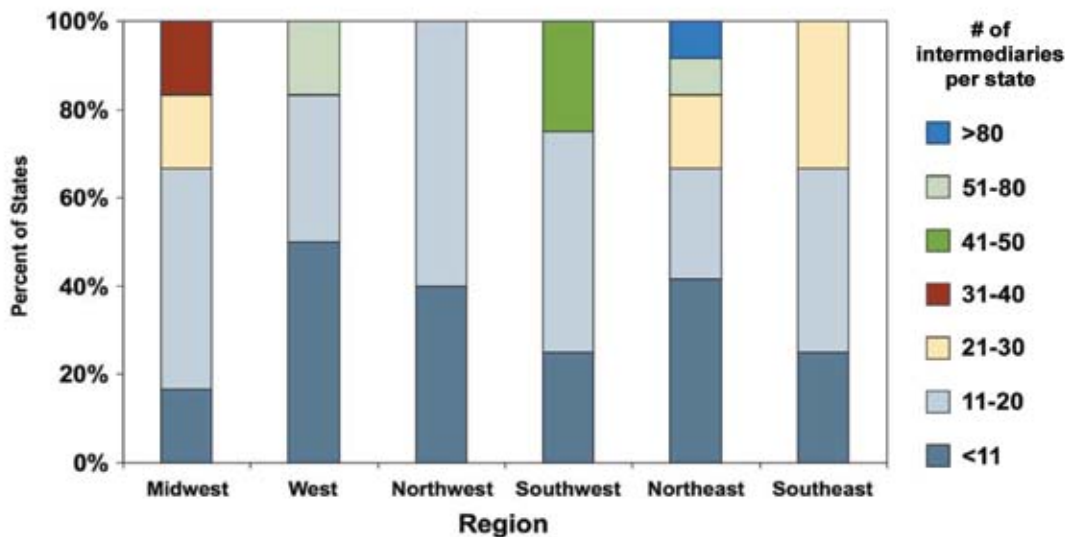
Kentucky Highlands Investment Corporation: Rural Economic Development

For nearly 50 years, the Kentucky Highlands Investment Corporation (KHIC) has been focused on stimulating economic growth and job creation in the rural communities of southeastern Kentucky. It works toward this goal by providing equity and debt capital as well as technical assistance to businesses with operations in this area. To date, KHIC has helped 220 businesses finance \$178 million and create more than 9,900 jobs.

Kentucky Highlands has achieved such results through an increasingly sophisticated array of investment and development strategies, ranging from a \$40 million venture capital fund to loan programs with investments ranging from \$500 to \$10 million. It also has subsidiaries that include an industrial real estate development corporation and a management consulting company.

Source: www.khic.org.

Concentration of Non-national Economic Development Intermediaries by State



		MIDWEST	WEST	NORTHWEST	SOUTHWEST	NORTHEAST	SOUTHEAST
Avg # of Economic Development Intermediaries per State	Avg without national intermediaries ²⁶	21	16	11	19	22	16
	Avg with national intermediaries	25	24	21	32	27	20

²⁶ Our research found 51 economic development focused investment intermediaries that officially invest nationally. However, many of these organizations typically focus their efforts on several key regions so they do not actually serve all 50 states.

Housing

Investing in affordable housing development, particularly through intermediaries, is one of the early success stories of mission investing. Housing development is well-suited to investment as the results are tangible assets that appreciate over time and can be sold or used as collateral. Mortgages, even to lower-income buyers, can be pooled and securitized by intermediaries, creating liquidity and reducing risk in ways that a direct investments cannot.

Housing intermediaries take several forms.

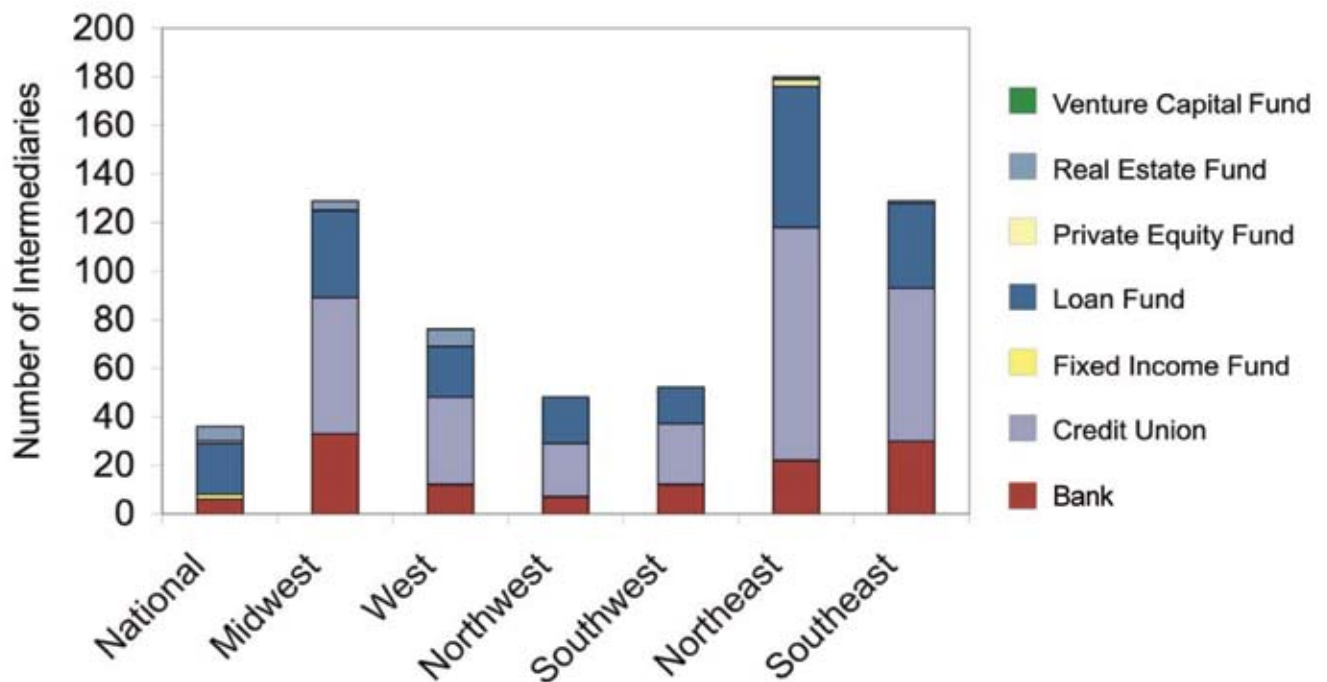
- Banks and credit unions that provide mortgages for low-income populations to enable them to purchase available housing stock.
- Loan funds that provide capital to housing developers or low-income homebuyers. Many loan funds are

administered by affordable housing developers, often in the form of nonprofit community development corporations or other entities.²⁷

- Intermediaries that develop or rehabilitate affordable housing units for rental or sale.
- Real estate funds that focus on urban redevelopment that includes an affordable housing component.
- Securitized pools of mortgages.

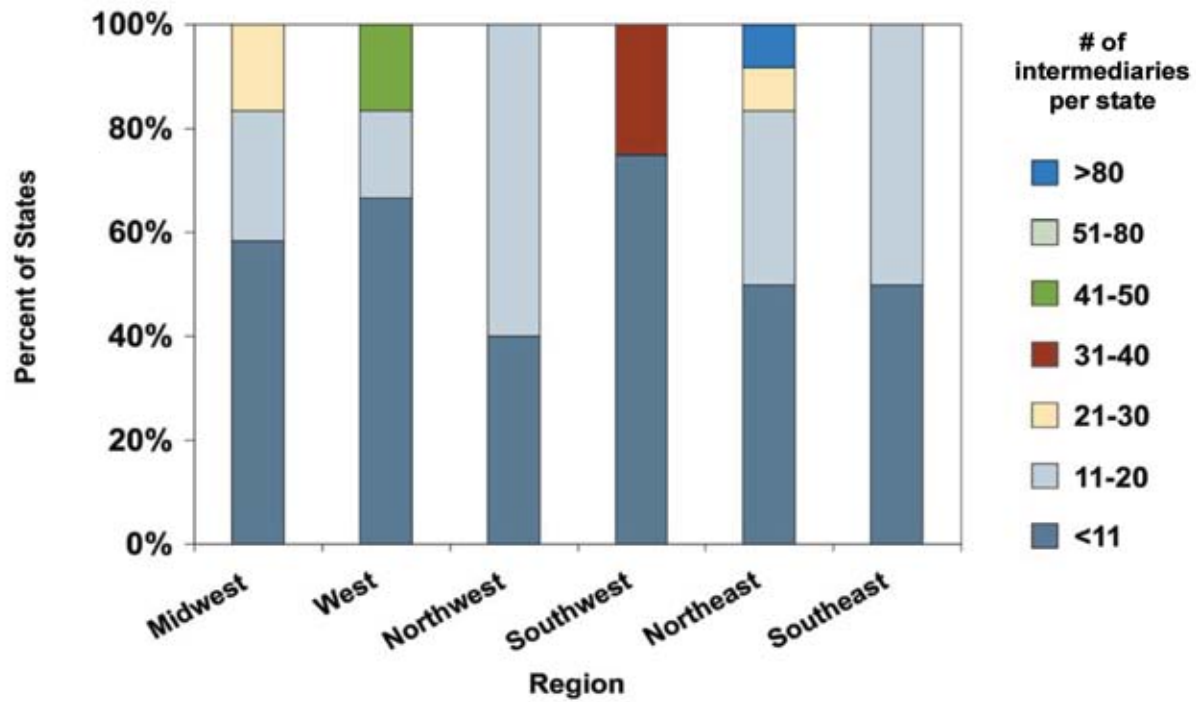
The distribution of housing intermediaries by region is very similar to that of economic development intermediaries. New York far outpaces other states with 70 intermediaries, while California (42) and Texas (34) finish the top three. Though most states have far fewer housing intermediaries, every state in the country has at least two that address local housing issues.

Number of Housing Intermediaries by Type and Region Served



²⁷ Some of these organizations have official loan funds while others function as loan funds without the official designation. If an organization is collecting capital to relend it, we classified it as a loan fund, whether it has the official designation or not.

Concentration of Non-national Housing Intermediaries by State



		MIDWEST	WEST	NORTHWEST	SOUTHWEST	NORTHEAST	SOUTHEAST
Avg # of Housing Intermediaries per State	Avg without national intermediaries ²⁸	11	13	10	13	15	11
	Avg with national intermediaries	14	19	17	22	18	14

²⁸ Our research found 36 housing-focused investment intermediaries that officially invest nationally. However, many of these organizations typically focus their efforts on several key regions so they do not actually serve all 50 states.

Enterprise Community Partners: Scaling Housing Development

Every 80 minutes, someone in the United States moves into a house that Enterprise Community Partners helped to create. Enterprise helps build affordable housing for low-income Americans by providing loans, grants, and information resources to community and housing developers. In addition, its for-profit subsidiary, Enterprise Community Investment, offers tax credit financing and asset management services. Beyond its work in creating affordable housing, Enterprise is also a leading advocate for federal and local policy in support of affordable housing and community development.

With 17 offices across the United States, Enterprise Community Partners has invested over \$8 billion since its inception in 1982 and has built or preserved 215,000 affordable homes. In order to achieve this scale of impact, Enterprise works closely with government agencies, developers, and nonprofits. For example, Enterprise and the Corporation for Supportive Housing launched The Supportive Housing Investment Partnership (SHIP) to help developers create 3,000 homes with medical care, substance-abuse counseling, and other services for those who are homeless or at risk for becoming homeless.

Enterprise obtains the capital required for its lending from numerous donors and investors, including dozens of foundations, banks, and corporations. It also has been adept at leveraging tax credits and government funding to support its work. For example, Enterprise leveraged New Markets Tax Credits to help generate nearly \$19 million to acquire parcels of land in East Baltimore for critical redevelopment.

Source: www.enterprisecommunity.org.

Environment

Among the three issue areas studied, the environment is served by far fewer investment intermediaries. With very few exceptions, the robust CDFI infrastructure that serves economic and community development as well as housing does not focus on the environment. Two-thirds of the environmentally-focused investment intermediaries have a broad national scope: we found no regionally focused environmental intermediaries for 23 states.

The national intermediaries that address the environment are also of a significantly different character than those in economic development or housing. Fifty-four of the 93 environmental intermediaries in our study are positively screened SRI mutual funds that invest in the public equities

of companies with good environmental records such as pollution-limiting policies and energy efficient operations along with other positive social and governance criteria.

Other national environmental intermediaries include venture capital, real estate, and fixed income funds. “Green” venture capital funds have recently enjoyed prominence, enabling foundations to provide capital to companies that are developing alternative energy options and energy efficient technologies. Though less common, a growing number of “green” real estate funds reflect the newer trend of investing in properties with positive environmental characteristics. A majority of the regional intermediaries are loan funds that lend to companies that operate sustainably or work toward conservation or environmental cleanup. The northeast also has a small concentration of real estate funds that invest in environmentally-friendly real estate development.

Unlike the large majority of intermediaries we studied for economic development and housing — with clearly targeted missions and investment protocols that focus on one or both of these issues — only about a dozen of the environmental intermediaries we found focus exclusively on the environment. Many of the regional loan funds that lend to sustainable businesses appear to be as much or more focused on economic

development as on the environment. Among the national public equity funds with positive environmental screens, other considerations such as corporate governance or labor conditions may carry equally significant weight. As a result, foundations with environmental programs may find fewer intermediary options that truly fit their programmatic objectives.

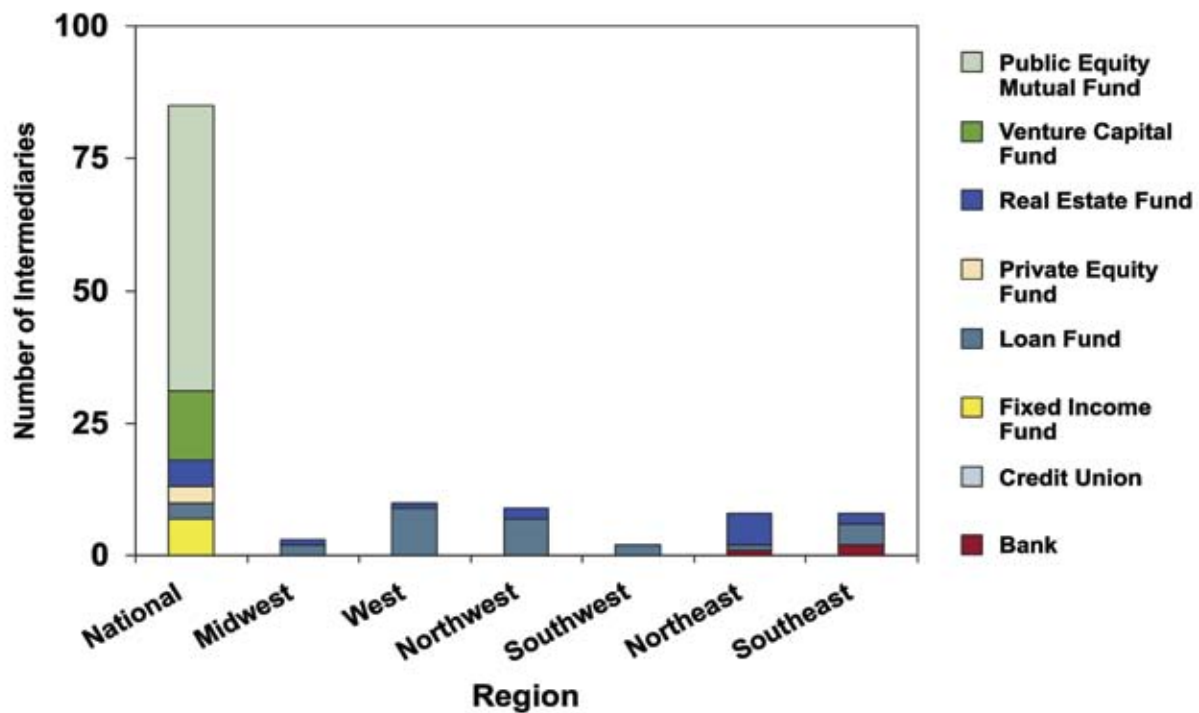
Coastal Enterprises

Coastal Enterprises Inc. (CEI) is a private, nonprofit Community Development Corporation (CDC) and CDFI that develops job-creating natural resources and small business ventures in rural Maine, northern New England, and upstate New York. Founded in 1977, CEI simultaneously utilizes investments, technical assistance, and policy advocacy to support economic and community development in these regions.

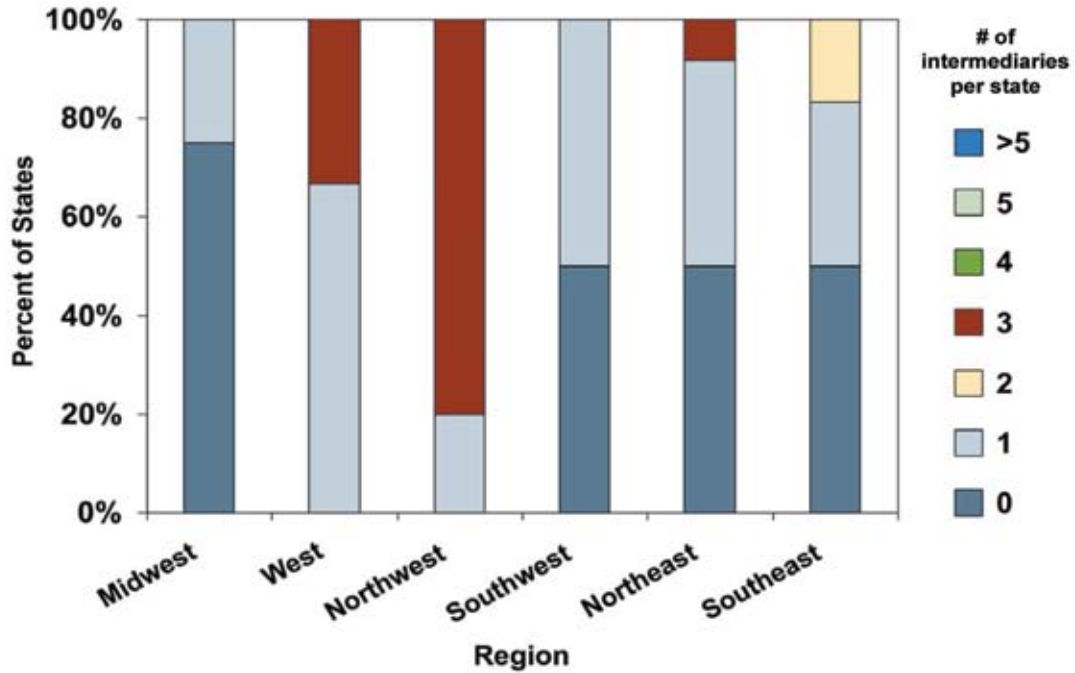
CEI's investments in small businesses include both debt and equity. CEI makes direct loans ranging from \$1,000 to \$500,000 to small Maine businesses while two of CEI's subsidiaries, CEI Ventures, Inc. and CEI Community Ventures, Inc., are investing \$35 million in venture capital. Foundations such as the W.K. Kellogg Foundation provide capital for these investments by making low-interest loans to CEI or equity investments in its venture capital funds.

Source: www.ceimaine.org.

Number of Environment Intermediaries by Type and Region Served



Concentration of Non-national Environment Intermediaries by State



		MIDWEST	WEST	NORTHWEST	SOUTHWEST	NORTHEAST	SOUTHEAST
Avg # of Environmental Intermediaries per State	Avg without national intermediaries ²⁹	0.3	1.8	1.8	0.5	0.7	0.7
	Avg with national intermediaries	6.8	14.8	17.6	20.3	7.3	7.3

Sea Change: Leveraging Market Forces to Support Sustainable Fishing

Studies have shown that many consumers prefer fish caught or raised through sustainable fishing practices, but the lack of any specialized wholesalers has meant that there is no way to keep such fish separate through the distribution chain to the ultimate consumer. To solve this problem, the Sea Change Investment Fund, LLC, a San Francisco-based private equity firm, was established in 2005 to invest in companies that promote market access to seafood from environmentally-preferable sources. Capitalized with a \$10 million program-related seed loan from the David and Lucile Packard Foundation and matched by private equity investment, the fund blends philanthropic and private capital to support sustainable fishing.

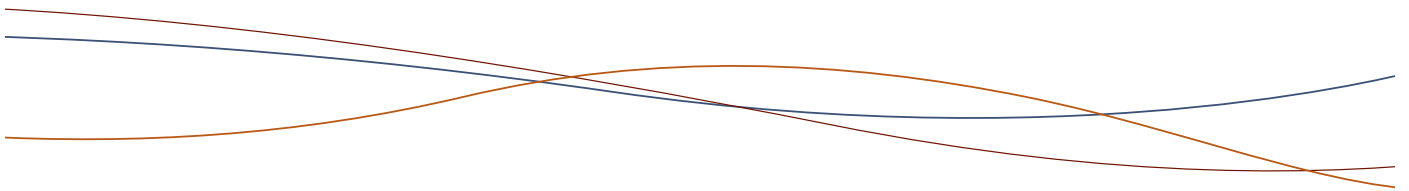
Sea Change has invested in companies such as EcoFish, a supplier and marketer of seafood exclusively from environmentally sustainable sources. EcoFish provides seafood to over 125 upscale restaurants nationwide.

Source: www.seachangefund.com.

²⁹ Our research found 79 environment-focused investment intermediaries that officially invest nationally. However, many of these organizations typically focus their efforts on several key regions so they do not actually serve all 50 states.

EXPANDING THE REACH OF MISSION INVESTMENT INTERMEDIARIES

Rather than waiting for new investment intermediaries to form, foundations can proactively help to develop new intermediaries by providing leadership and investment capital.



Expanding the Reach of Mission Investment Intermediaries

Our research on economic development, housing, and environmental mission investment intermediaries has documented more than a thousand intermediaries operating throughout the United States, yet there are many regions where no intermediary is active on one or several of these issues. In addition, there are many other issue areas of interest to funders where few mission investment intermediaries are currently operating. Developing new intermediaries to fill these gaps or new products at existing intermediaries would bring significant advantages by enabling easier investment from funders, attracting diverse sources of capital from different types of investors, or providing expertise and technical assistance to social enterprises. Rather than waiting for new investment intermediaries to form, foundations can proactively help to develop new intermediaries or work with existing intermediaries to expand their offerings by providing leadership and investment capital.

For example, The Paul and Phyllis Fireman Charitable Foundation, The Highland Street Foundation, The Hyams Foundation, The Boston Foundation, and The Mellon Charitable Giving Program/Peter E. Strauss Trust pooled capital to start HomeFunders, a loan fund for the development of affordable housing in Massachusetts. Thirteen other funders have since joined the fund, building a pool of \$26 million for low-interest development loans. The fund is anticipated to make available 3,000 units of affordable housing for extremely low-income families over the next ten years.³⁰

Foundations can also collaborate with CDFIs and other intermediaries to import existing investment models to different regions. Building on the expertise of existing intermediaries can avoid inefficiencies and reap the benefits of the lessons learned by these organizations. For example, American Ventures Realty Investors has worked with several foundations to set up regional Urban Initiatives Funds to spur urban redevelopment.³¹ These real estate mezzanine debt funds provide market-rate capital to qualified developers of urban core development projects. With the McCune Charitable Foundation as the lead investor, American Ventures Realty Investors created a \$30 million fund for New Mexico in 2003. With the John S. and James L. Knight Foundation as a major investor, they created a

a similar fund for South Florida in 2004. Based on the success of these funds, American Ventures is now planning to start other regionally-focused funds across the country.

Root Capital: Extending Successful Intermediaries into New Regions

By providing capital and program expertise about local needs, foundations can serve as catalysts for intermediaries' expansion into new geographical regions and issue areas.

Root Capital (formerly EcoLogic Finance), a "green" loan fund headquartered in Cambridge, Massachusetts, lends to community-based businesses operating in environmentally sensitive areas of Latin America, Africa, and Asia.

The David and Lucile Packard Foundation, a private foundation headquartered in Los Altos, California, has a program area focused on the environmental conservation in the Gulf of California in Mexico, an area in which Root Capital had not previously been active.

In 2004, the Foundation approached Root Capital about establishing a lending program to help local fishermen replace outdated outboard motors with newer versions that release less fuel into the water and are more efficient, requiring substantially less fuel to operate. After considering the opportunity, Root Capital agreed that such a project aligned well with its goals of economic development and environmental stewardship. "We wouldn't be operating there, at least as early as we were, without the Packard Foundation's support," said Willy Foote, Director of Root Capital. "It turned out to be a great partnership. Their knowledge of the area's environmental needs and fishing dynamics and our loan program infrastructure and expertise were a natural fit."

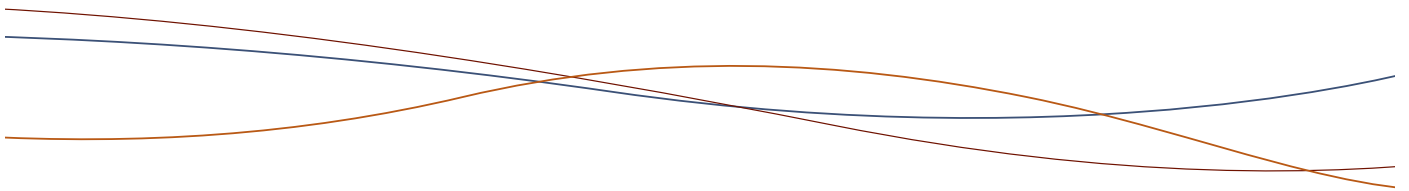
Source: Foote, William, "Swimming Against Tide of Overfishing", Los Angeles Times, December 29, 2002.; www.rootcapital.org; www.packard.org.

³⁰ HomeFunders Web site: www.homefunders.org.

³¹ American Ventures Web site: www.americanventures.com.

CONCLUSION

Their skills, relationships, technical assistance, and ability to assemble complex financing packages enable intermediaries to add value that funders can rarely achieve through direct mission investing.



Conclusion

Funders confront a difficult dilemma. Many of the social ills that they seek to address are inextricably tied to the for-profit capital markets, whether reducing poverty through job creation, the construction and purchase of housing, or the sources of energy that power commercial and residential properties. Yet most funders have chosen to address these issues exclusively through the nonprofit sector, relying on a very lean staff that is often barely able to keep up with the influx of grant applications. Funders that have begun to recognize the power of mission investing to complement and leverage their grantmaking strategies – as an increasing number of foundations have – find that they are missing the excess staff capacity, combination of skills, and network of relationships necessary to effectively find, negotiate, and track the performance of a complex portfolio of mission investments.

Some foundations have sidestepped this dilemma by limiting their mission investments to low-interest grantee loans, staying within the ambit that they know well. Others have launched a sufficiently ambitious mission investment program to warrant hiring staff with the requisite skills and developing the networks and processes necessary to manage mission investments successfully. Many funders fall in between these extremes, however, and are struggling with the challenge of adding mission investing to their already burdensome workload. For these funders in particular, well-managed mission investment intermediaries that share the funder's geographical and issue area focus offer an efficient and effective solution. It is our hope that the research and database we have created through this project will help funders find and invest significant capital into these intermediaries.

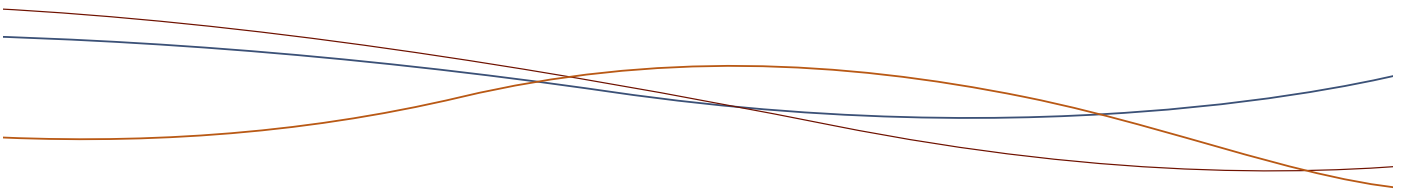
As we have emphasized throughout this report, however, the benefits of mission investment intermediaries are not limited to easing the demands on foundation staff. Their skills, relationships, technical assistance, and ability to assemble complex financing packages that leverage tax credits and varied sources of non-philanthropic capital, enable intermediaries to add value in ways that funders could rarely achieve through direct mission investing. Yet there remain gaps in issue areas and geographical regions where no such intermediaries exist. This provides an opportunity for funders to leverage their own investments by creating new intermediaries or partnering with existing intermediaries to extend their reach into new areas.

Intermediaries often create value in ways that funders are unable to achieve through direct mission investing.

After all, funders are constantly seeking the elusive project that will leverage their support many times over and ultimately become a self-sustaining enterprise. Supporting the formation and expansion of mission investment intermediaries in their areas of interest may be one of the few opportunities funders have to realize that vision.

APPENDIX:

- Sources Used
- Additional Resources
- Defining Mission
Investment Terminology



Sources Used

Publications

- Carlson, Neil, *Assessing and Managing PRI Risk: Nothing Ventured Nothing Gained*, Grantcraft, 2007.
- The CDFI Data Project, *Providing Capital, Building Communities, Creating Impact, FY 2005 Data Fifth Edition*, The CDFI Data Project, 2006.
- Community Development Venture Capital Association, “Boston Community Venture Fund and City Fresh Foods: Engineering An Exit, a Case Study”, Community Development Venture Capital Association, 2003.
- Cooch, Sarah and Kramer, Mark, *Compounding Impact*, FSG Social Impact Advisors, 2007.
- Kramer, Mark and Cooch, Sarah, “The Power of Mission Investing”, *Stanford Social Innovation Review*, Fall 2007.
- F.B. Heron Foundation, “Stories From the Field: McAuley Institute/Success Measures Project”, F.B. Heron Foundation, 2003.
- Foote, William, “Swimming Against Tide of Overfishing”, *Los Angeles Times*, December 29, 2002.
- International Grantmaking Update, Foundation Center, October 2006.
- New Markets Tax Credit Fact Sheet, New Markets Tax Credit Coalition, February, 2007.
- Pivo, Gary, *Responsible Property Investing: a Survey of American Executives*, University of Arizona, 2007.
- 2005 Report on Socially Responsible Investing Trends in the United States, Social Investment Forum, January 2006.
- “Success Measures: Transforming Outcome Measurement”, NeighborWorks America, 2005.
- U.S. General Accounting Office (GAO), Report to Congressional Committtes: Tax Policy, January 2007.

Web sites

American Ventures	www.americanventures.com
Calvert Foundation	www.calvertfoundation.org
CDFI Data Project	www.cdfi.org/cdfiproj.asp
CDFI Fund	www.cdfifund.org
Coastal Enterprises, Inc.	www.ceimaine.org
Community Development Venture Capital Association	www.cdvca.org
The Community Investing Center	www.communityinvest.org
The David and Lucile Packard Foundation	www.packard.org
Enterprise Community Partners	www.enterprisecommunity.org
HomeFunders	www.homefunders.org
Research Initiative on Social Entrepreneurship (RISE) at Columbia Business School	www.riseproject.org
Root Capital	www.rootcapital.org
Sea Change Investment Fund	www.seachangefund.com
ShoreBank	www.shorebankcorp.com
SocialFunds.com	www.socialfunds.com
Social Investment Forum	www.socialinvest.org
TIAA-CREF	www.tiaa-cref.org

Helpful Resources on Investment Intermediaries

Community Development Financial Institutions (CDFIs) – Community Development Banks, Credit Unions, Loan Funds and Venture Capital Funds

- **The CDFI Data Project** www.cdfi.org/cdfiproj.asp
A collaborative initiative to create a data collection and management system that produces data for and about the community development finance field. The CDFI Data Project publishes a periodic study on CDFI performance and activity across the United States and offers a comprehensive database of CDFIs and their activities/performance for purchase.
- **The CDFI Fund** www.cdfifund.org
A program of the U.S. Department of Treasury that provides capital and assistance to CDFIs to spur economic revitalization and community development. The Fund's web site offers a searchable database of CDFI Fund award recipients.
- **Community Investing Center** www.communityinvest.org
A project of the Community Investing Program of the Social Investment Forum Foundation and Co-op America. The Center's mission is to provide financial professionals with information and resources to help them channel more money into community investing. This includes "how-to" guidance for investors and a searchable database of CDFIs and other community development investment intermediaries.
- **CDFI Assessment and Rating System (CARS)** www.opportunityfinance.net
CARS offers assessment reports on 28 CDFIs and is working on an additional 35 organizations in the future. CARS rates CDFIs' financial strength and performance in the areas of capital, assets, management, earnings, and liquidity. The financial analysis is supplemented by an evaluation of how well the CDFI is fulfilling its mission, including an assessment of its procedures for tracking the outcomes of its work.

Private Equity Funds and Venture Capital Funds

- **The Double Bottom Line Handbook: A Practitioner's Guide to Regional Double Bottom Line Investment Initiatives and Funds (2007)** sdsgroup.com/dbl-handbook.html
- **Research Initiative on Social Entrepreneurship (RISE) at Columbia Business School** www.riseproject.org
This initiative's web site offers a searchable listing of "double bottom line" investment funds.
- **Community Development Venture Capital Association (CDVCA)** www.cdvca.org
Association of community development venture capital and private equity firms. Offers searchable listing of community development venture capital funds.

Real Estate Funds

- **Foundations and Real Estate: A Guide for Funders Interested in Building Better Communities, Funders' Network for Smart Growth and Livable Communities, 2004.** See http://www.fundersnetwork.org/usr_doc/Foundations_and_Real_Estate-FINAL.pdf

Screened Public Equity Mutual Funds

- **Social Investment Forum** www.socialinvest.org
Web site of the trade association of the U.S. social investment industry and community. Offers a searchable listing of screened public equity mutual funds.
- **SocialFunds.com** www.socialfunds.com
A web site devoted to social investing, particularly through public equity mutual funds. The site offers a searchable listing of screened public equity mutual funds.

Defining Mission Investment Terminology

Definitions

Mission investing is the practice of using financial investments as tools to further a foundation's mission. Mission investments can take the form of debt or equity and can be funded by either program or endowment funds. They provide a unique and flexible complement to more conventional philanthropic devices such as grants.

Mission investments can be grouped into two broad categories based on their level of expected financial return:

- Market-rate mission investments
- Below market-rate mission investments

Mission investments are financial investments made with the intention of (1) furthering a foundation's mission and (2) recovering the principal invested or earning financial returns.

A **market-rate mission investment** has an expected financial return approximating the average risk-adjusted rate of return of a similar investment made without regard to social or environmental considerations.

Three factors determine market rates of return: asset class, risk level, and market timing. The asset class, or investment type, has a major influence on returns. For example, an insured deposit has a much lower expected return than a venture capital fund. Even within an asset class, the risk level of an investment also influences the return. A very low-risk loan will have a much lower interest rate than a loan to a riskier borrower. Finally, because rates of return fluctuate over time, a specific rate of return might be at market levels in one year but not another.

Below market-rate mission investments have expected financial returns that are less than risk-adjusted market-rate levels. A foundation might, for example, provide an interest-free loan to a nonprofit organization. The foundation might make such an investment because the transaction would be impossible at market rates or simply because it prefers to have the money used for social objectives rather than to earn a profit for itself.

The majority of below market-rate mission investments made by foundations are **program-related investments (PRIs)**. PRIs are an exception to the Tax Reform Act of 1969, which stipulates that private foundations must avoid investments that might jeopardize their ability to carry out their mission. Private foundations are allowed to make investments with higher than normal risk levels if these investments meet three criteria:

1. "The primary purpose is to accomplish one or more of the foundation's exempt purposes,
2. Production of income or appreciation of property is not a significant purpose, and
3. Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose."³²

Therefore, if a private foundation makes a below market-rate investment, it almost always classifies it as a PRI. These rules do not apply to community foundations, which the IRS classifies as public charities, not private foundations.

Until the mid-1990s, all the mission investments made by private foundations were classified as PRIs. The last ten years, however, have seen experimentation by some private foundations with non-PRI investments. In 2005, 15% of private foundation mission investments were not classified as PRIs.

³² IRS Web site: <http://www.irs.gov/charities/foundations/article/0,,id=137793,00.html>.

Nearly all PRIs are below market-rate investments even though legal requirements do not explicitly stipulate below-market returns.

Nearly all PRIs are below market-rate investments even though legal requirements do not explicitly stipulate below-market returns. In fact, the tax code states that a significant return does not in itself disqualify an investment as a PRI: “If an investment incidentally produces significant income or capital appreciation, this is not, in the absence of other factors, conclusive evidence that a significant purpose is the production of income or the appreciation of property.”³³ However, many foundations have interpreted the IRS rules to mean that they are not permitted achieve market or near-market returns with their PRIs, and they therefore only classify below market-rate mission investments as PRIs.

Due to the primary focus on charitable benefit, some foundations view PRIs as extensions of their grantmaking efforts. In fact, if a private foundation claims an investment as a PRI on its annual IRS Form 990-PF, it can include the amount in its annual payout requirement. However, the foundation’s payout requirement for the year in which the investment is repaid is increased by the amount of the principal recovered.

“Should a private foundation be more than a private investment company that uses some of its excess cash flow for charitable purposes?...The question above, answered in the affirmative by our Board, has shaped our thinking and practice.”³⁴

– Luther Ragin Jr., The F.B. Heron Foundation

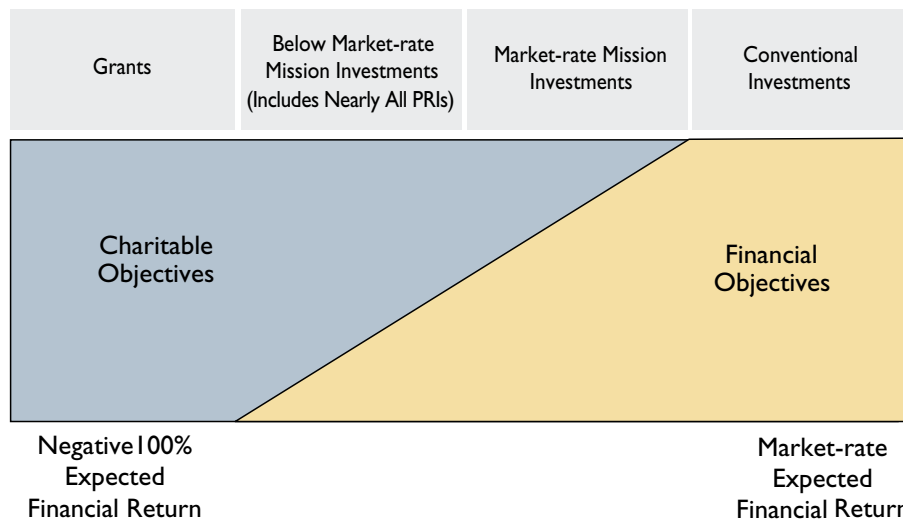
Motivations

Foundations have three primary motivations for engaging in mission investing:

1. **Recovering philanthropic funds for future use.** Unlike grants, mission investments return capital to a foundation that can be “recycled” for future philanthropic activities. As a result, the foundation can achieve multiple social benefits with the same dollars. Even if a mission investment has a zero percent expected rate of return, it has a positive financial impact relative to a grant which has a negative 100% financial return. One private foundation CEO we interviewed remarked, “I’m baffled as to why foundations don’t do more of this. They’re giving their money away now [through grants]. Why not get some of it back and still address the same goals?”
2. **Achieving social benefits in ways that grants cannot.** Mission investments enable foundations to work toward their mission goals in new ways and with new partners. Given their structure, investments can sometimes fill needs that grants cannot address. For example, a loan can help a nonprofit build a credit history, which is important for its dealings with other creditors, or an investment in a venture capital fund can spur economic development in ways that a grant cannot.

By taking the lead in new kinds of market-rate investments that are not yet available in commercial markets, foundations can also encourage other investors such as pension funds and educational endowments to invest, greatly leveraging their own funds. Microfinance, for example, was pioneered by foundations but has demonstrated sufficiently attractive

Spectrum of Foundation Investments



returns to attract billions of dollars of ordinary investment capital. Foundations can also take a subordinate position in a mission investment, taking on more risk to make the investment feasible for conventional sources of capital.

3. **Aligning assets with the mission.** Typically, foundations allocate a very small percentage of their total assets to grantmaking and invest the bulk purely to maximize financial returns. Allocating at least a portion of its endowment assets to mission investments enables a foundation to leverage more of its assets to achieve its core goals.

Approaches

Foundations use three different approaches for mission investing, either separately or in combination:

Screening: Social or environmental criteria, or “screens,” can be used to guide investments in public securities, either directly or through socially responsible investment (SRI) mutual funds. Negative screens, such as avoiding tobacco companies, prevent a foundation from owning stock in companies with operations or products that conflict with its mission. They can also help safeguard its reputation.³⁵ Negative screens may avoid a conflict, but do not necessarily result in investments that actually advance the foundation’s mission. Positive screens, such as targeting companies that have strong environmental records, may yield investments if the screening criteria are specifically tied to the foundation’s mission. Otherwise, these screened investments would qualify as social investments but not mission investments.

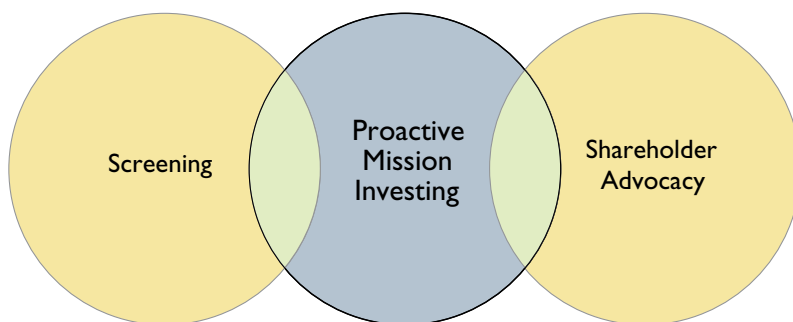
Although SRI funds are the most well known social investment vehicle, very few of the foundations FSG has studied have made such investments. Several noted that they previously held such investments but divested them because they did not see a clear connection to their missions, and the funds’ performance was not attractive enough to warrant keeping the investments purely for financial reasons.

Shareholder advocacy and proxy voting: Equity investments can provide a foundation with the opportunity to advocate as a shareholder, through dialogue with corporate management, shareholder resolutions, and proxy voting, in order to influence a corporation’s behavior in a way that furthers the foundation’s mission.³⁶

Foundations are increasingly using the leverage that their stock portfolios provide to advocate for social and environmental concerns, sometimes reflecting general social values and other times reflecting the foundations’ specific missions. Our definition of mission investments, however, focuses on whether the investment was *made with the intention* of achieving a mission-related objective.

Proactive mission investing: The primary mission investing approach used by foundations FSG has studied is to make proactive, targeted investments, either directly or through intermediaries, in organizations or companies that create social impact.

Mission Investment Approaches Used by Foundations



³³ IRS Web site: <http://www.irs.gov/charities/foundations/article/0,,id=137793,00.html>.

³⁴ Ragin Jr., Luther. “New Frontiers in Mission Investing.” The FB. Heron Foundation, 2004.

³⁵ Recent Los Angeles Times articles on the endowment investing practices of the Bill and Melinda Gates Foundation made clear to many foundations the potential for public scrutiny of their investing approach.

³⁶ MacKerron, Conrad and Doug Bauer. “Unlocking the Power of the Proxy.” Rockefeller Philanthropy Advisors, As You Sow Foundation, 2004, www.ceres.com.

Terminology

Foundations use many terms to refer to what we call mission investing. As the practice of mission investing grows, however, it is vital that the sector adopts a common terminology.

We chose the term *mission investing* because it conveys the purpose of these investments. We did not use the similar but distinct term *mission-related investing* because this term is sometimes used to refer to only market-rate investments or only investments made using endowment funds.

We use the term *program-related investments* to refer only to investments made by private foundations that meet the IRS requirements for PRIs. This term is sometimes used to refer to any foundation investment that is tied to the mission, regardless of whether it is made by a private foundation or whether it actually meets the tax code requirements for a PRI. As program-related investment is the one term in this area that has a legal definition, we chose to use it in the strictest sense.

We use two other terms in specific ways:

- *Social investing*: The general practice of considering social and environmental factors in investment decisions. Social investors include individuals, foundations, pension funds, corporations, and educational endowments.
- *Socially responsible investing*: The practice of using social, environmental, and corporate governance criteria for selecting securities, usually in screened mutual funds.

In both these approaches, the non-financial factors considered reflect the values of the social investor but may not necessarily be tied to the investing organization's core mission. For example, an organization may make a values-driven choice not to invest in tobacco companies, even though its core goals are unrelated to healthcare. In contrast, mission investing is intended to further a foundation's specific mission.

