Compounding Impact:
Mission Investing by US Foundations

Sarah Cooch & Mark Kramer
with Fi Cheng, Adeeb Mahmud, Ben Marx and Matthew Rehrig

FSG SOCIAL IMPACT ADVISORS

Funded by
the David & Lucile Packard FOUNDATION

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 vehicle.

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

Acknowledgements

FSG Social Impact Advisors gratefully acknowledges the financial support and guidance for this project from the David and Lucile Packard Foundation.

This study would not have been possible without the much appreciated assistance of the 92 US foundations that participated in interviews and provided data on their mission investments. We thank each of them for their generous contributions of time and information.

FSG also thanks Kim Honor and the PRI Makers Network for their endorsement of this study and their assistance in encouraging their members to participate in the project.

Disclaimer

All statements and conclusions, unless specifically attributed to another source, are those of the authors and do not necessarily reflect those of the foundations who participated in the study, the David and Lucile Packard Foundation, or members of our Advisory Board.

Advisory Board

An Advisory Board comprising key practitioners and experts in the field of social and mission investing provided vital counsel for this project. FSG sincerely thanks them for their guidance and insight, particularly Luther Ragin, Jr. who provided exceptional support and counsel.

- Senior Advisors
  - **Jed Emerson**, *Senior Fellow*, Generation Foundation
  - **Luther M. Ragin Jr.**, *Vice President, Investments*, F.B. Heron Foundation
- Advisors
  - **Shari Berenbach**, *Executive Director*, Calvert Foundation
  - **David Carrington**, *Independent Consultant* (UK)
  - **Robert S. Collier**, *President and CEO*, Council of Michigan Foundations
  - **Bill Drayton**, *CEO, Chair, and Founder,* Ashoka
  - **John Edie**, *Director,* PriceWaterhouseCoopers
  - **Timothy Freundlich**, *Director of Strategic Development*, Calvert Foundation
  - **Jacqueline Khor**, *Assistant Director*, Program Venture Investments, Rockefeller Foundation
  - **Doug Kridler**, *President and CEO*, The Columbus Foundation
  - **David Kyle**, *COO*, Acumen Fund
  - **Ronn Richard,** *President*, Cleveland Foundation
  - **Mary Anne Rodgers**, *Foundation Counsel and Director of Program-Related Investments*, The David & Lucile Packard Foundation
  - **Buzz Schmidt**, *Founder and President*, Guidestar
  - **Edward Skloot**, *Executive Director*, Surdna Foundation
  - **Burt Sonenstein**, *Chief Financial Officer*, Annie E. Casey Foundation
  - **Christa Velasquez**, *Director of Social Investments*, Annie E. Casey Foundation
  - **John Weiser**, *Partner,* Brody Weiser Burns

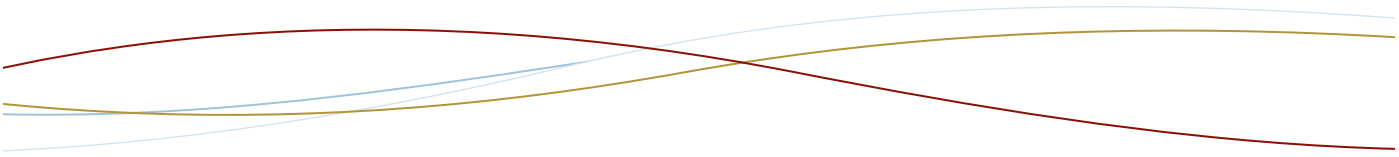
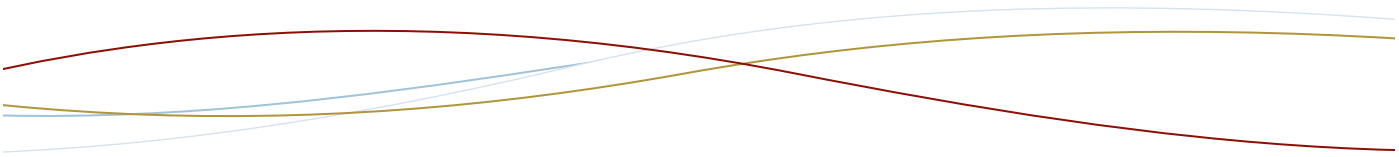


TABLE OF CONTENTS

EXECUTIVE SUMMARY

This study offers the first comprehensive look at the landscape of mission investing by US foundations.



Executive Summary

Mission investing – the practice of using financial investments as tools to achieve a foundation's mission – is gaining momentum among US foundations. Mission investments' annual growth rate averaged 16.2% in the last five years, compared to just 2.9% during the preceding 32 years. Over the past decade, the number of foundations engaging in mission investing has doubled, and the new funds invested annually have tripled. Mission investments are also diversifying. Once largely restricted to low-interest loans, they now span a wide spectrum of debt and equity 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 return.

This study offers the first comprehensive look at the current and historical landscape of mission investment activity by US foundations. Funded by a grant from the David and Lucile Packard Foundation and guided by an Advisory Board of leading experts and practitioners, FSG Social Impact Advisors studied the mission investment practices of 92 US foundations that together have made $2.3 billion worth of mission investments.[1]

Through interviews with each foundation and the collection of extensive data on individual investments and their financial returns,[2] we assembled a rich picture of current and historical mission investment activity stretching back nearly 40 years.

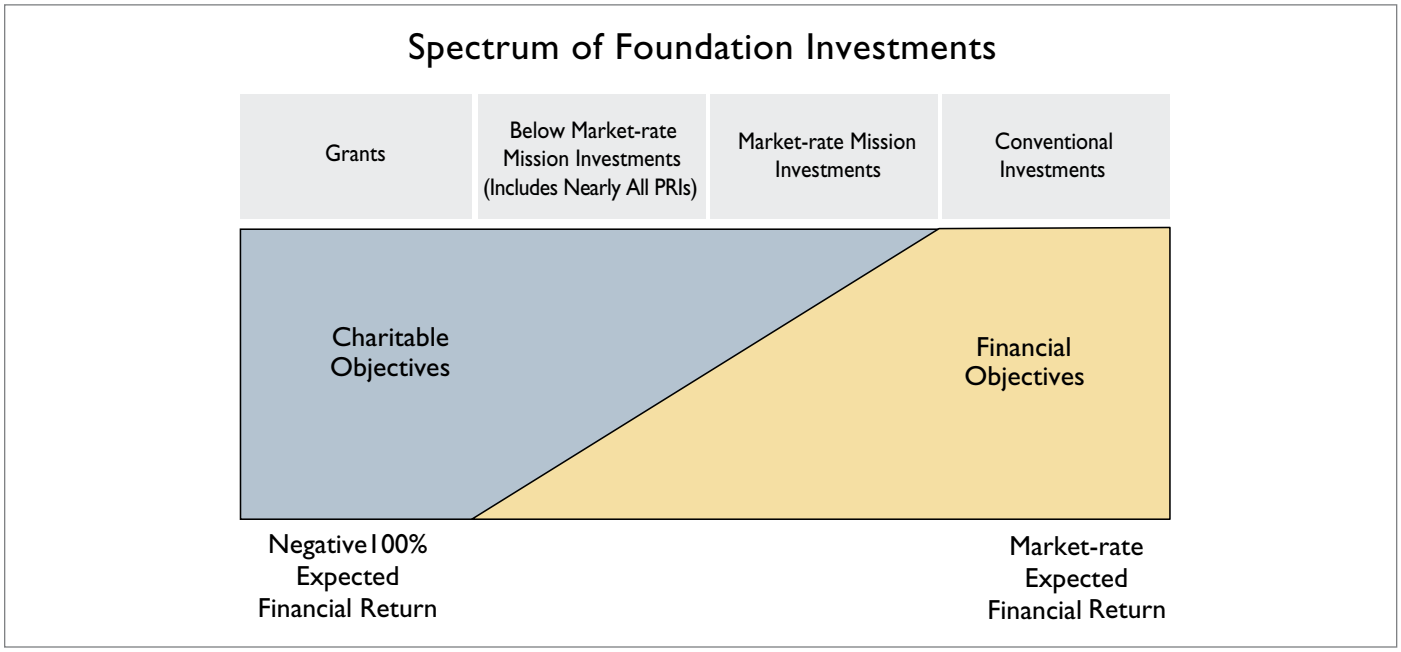
This study offers the first comprehensive look at the landscape of mission investing by US foundations.

Mission Investments Defined

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 return. Mission investments can take the form of debt or equity and can be funded by either program or endowment funds.

Mission investments can be grouped into two broad categories:

1. ***Market-rate mission investments*** seek financial returns approximating the average risk-adjusted returns of similar investments made without regard to social or environmental considerations.
2. ***Below market-rate mission investments*** seek financial returns lower than the risk-adjusted average. Foundations make below-market investments when their objectives cannot be achieved through market-rate investments or when they prefer to use excess funds for charitable objectives rather than to earn a profit. Private foundations may also make below-market mission investments and claim them as ***program-related investments (PRIs)***, a type of investment made that meets certain guidelines set forth in the Internal Revenue Code. PRIs can count toward private foundations' annual payout requirement. Nearly all PRIs have below market-rate expected financial returns, though IRS regulations do not prohibit market-rate financial returns as long as other conditions are met.



[1] In constant 2005 dollars based on annual average CPI of all urban consumers as reported by the US Department of Labor.
[2] The majority of the participating foundations provided data on their individual investments. Those that did not cited a lack of staff to gather the information requested.

Over the past decade, the number of foundations engaging in mission investing has doubled, and the new funds invested annually have tripled.

Approaches

Foundations can take three approaches to mission investing:

1. ***Screening:*** A foundation uses social or environmental criteria, or "screens", to align its investments in public securities with its mission, either directly or through socially responsible investment (SRI) mutual funds. Screens can be negative (*e.g.*, avoid tobacco companies) or positive (*e.g.*, focus investments on "green" companies).
2. ***Shareholder advocacy and proxy voting:*** A foundation uses its investments as a means to engage in shareholder advocacy – through dialogue with corporate management, shareholder resolutions, and proxy voting – to influence a corporation's behavior on issues relevant to the foundation's mission.
3. ***Proactive mission investing:*** A foundation invests in either for-profit or nonprofit enterprises with the intent of both achieving mission-related objectives and earning financial returns. Investments can be made directly or through intermediaries that aggregate and distribute capital. Proactive mission investments comprise the majority of investments studied in this report.

Smaller foundations accounted for 44% of all new mission investment dollars in 2005, representing an annual growth rate of 22% over the past five years.

Motivations

Foundations have three primary motivations for mission investing:

1. ***Recovering philanthropic funds for future use.*** Unlike grants, mission investments return capital to a foundation. They augment its resources by "recycling" funds for additional rounds of philanthropic activity.
2. ***Achieving social benefits in ways that grants cannot.*** Mission investments can sometimes achieve objectives that grants cannot, such as helping nonprofits establish credit or creating new financial instruments, such as microfinance funds, that can attract and leverage large amounts of non-philanthropic capital.
3. ***Aligning assets with the mission.*** As mission-driven organizations that serve the public good, foundations may seek to use their large reservoirs of investment capital to further their charitable objectives, or they may simply choose to align their investments more closely with their missions and values.

Major Findings

Mission Investing Activity

- Mission investing has increased significantly in the past five years. Foundations of all sizes and types (private, community, and corporate) are now active participants.
- The majority of private foundations' mission investing has been concentrated in program-related investments (PRIs).
- The PRI programs of four large foundations (the Ford Foundation, the David and Lucile Packard Foundation, the John D. and Catherine T. MacArthur Foundation, and one anonymous foundation) together account for most historical US

Mission Investment Asset Classes

Debt												
Conditional Investments		Deposits		Loans					Fixed Income Securities			
Loan Guarantee	Recoverable Grant	Insured Deposit	Linked Deposit	Senior Loan	Subordinated Loan	Line of Credit	Senior Loan Fund	Subordinated Loan Fund	Bond	Bond Fund	Mortgage Backed Security	Other Asset Backed Security

Equity						
Real Estate		Public Equity		Private Equity		
Real Estate (individual investments)	Real Estate Fund	Public Equity Fund (includes SRI Funds)	Direct Public Equity (individual companies)	Direct Private Equity (individual companies)	Private Equity Fund	Venture Capital Fund

Notes: This study collected data on at least one investment in each of these asset classes except Other Asset Backed Securities and Direct Public Equity. See the Appendix for definitions of each asset class.

mission investment activity. In recent years, however, mission investing by smaller foundations has grown rapidly. Smaller foundations accounted for 44% of all new mission investment dollars in 2005, representing an annual growth rate of 22% over the past five years, compared to a 13% growth rate for the most active four foundations. The fastest growth in participation has been among foundations with assets under $200 million.

Foundations are also beginning to use more market-rate investments — over the past five years this segment has grown three times as rapidly as below market-rate investments.

Mission Investment Structure and Performance

- The terms mission investment and PRI are used broadly to describe many types of investments. Our research disclosed 20 different asset classes that qualify as mission investments, all of which can be priced for either market or below-market returns. Among the foundations we researched, we found investments in 18 of these asset classes.
- Historically, foundations have concentrated their mission investments in low interest loans and loan guarantees to nonprofit organizations. Recent years, however, have seen increasing activity in other debt asset classes like insured deposits and loan funds, and in equity investments such as real estate and venture capital.
- Some 43% of foundations fund their mission investments exclusively from program funds, but nearly half have used endowment funds, either exclusively or in concert with program dollars.
- Although foundations have typically made direct investments, they are increasingly utilizing investment intermediaries such as community development financial institutions (banks, credit unions, loan funds, and venture capital funds).
- Foundations are also beginning to use more market-rate investments. In 2005, 11% of mission investments had market-rate expected financial returns, and over the past five years this segment has grown three times as rapidly as below market-rate investments. Here, too, smaller foundations are leading the way.
- Mission investments have focused on four issue areas: Economic Development, Housing, Education, and Environment. Together, these areas account for 85% of all mission investment dollars invested from 2001 to 2005. Investee types and asset classes vary widely by issue area.
- As the vast majority of completed mission investments are loans, meaningful financial performance data is only available for this asset class. Of the foundations that made loans over the past 40 years, 75% achieved a zero default rate.[3] At the other extreme, three foundations had cumulative default rates in excess of 30%, suggesting that they managed their portfolios differently from the rest. Excluding these three foundations, the overall repayment rate was 96%.

Mission Investing Management

- Most mission investment portfolios are managed primarily by program staff. Coordination between program and finance teams tends to be weak, with only about a quarter of foundations indicating that their program and finance staffs collaborate closely in managing mission investments. Forty percent of foundations report that lack of staff time or expertise limits their ability to make mission investments.
- Most foundations currently engage in mission investing only sporadically or devote only a small fraction of their assets to the practice, and few have developed internal processes and controls for managing mission investments on a consistent and reliable basis. Very few foundations have complete, accessible records of the financial performance of their mission investment portfolios, and even fewer foundations have attempted to measure the social impact of their mission investments. However, most of the foundations studied indicated an interest in increasing their mission investing activity and acknowledged the need to develop better organizational processes to support this work.

Of the foundations that made loans over the past 40 years, 75% achieved a zero default rate. Excluding three of 28 foundations with completed loans, the overall repayment rate was 96%.

Building on the Momentum

Our research disclosed many examples of foundations using innovative mission investments to achieve a wide range of charitable and financial objectives. The rapid growth in mission investments among US foundations of all sizes suggests that foundations are increasingly comfortable incorporating them into their philanthropic and investment strategies. Our research also suggests, however, that a lack of knowledge, communication, and opportunity is restricting further growth. The continued expansion and maturation of mission investing will require three key changes:

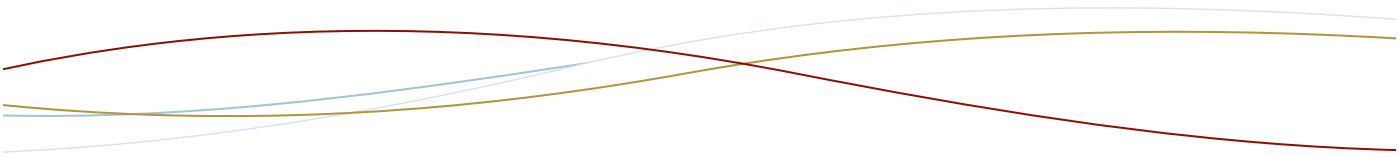
1. Greater understanding of and proficiency in mission investing among foundation staff and boards,
2. A more robust marketplace for mission investments, including direct investment opportunities, mission investment intermediaries, and suitably qualified consultants, and
3. Improved mission investment performance measurement, record keeping, and information sharing.

It is our hope that this report will help stimulate the discussion, research, and collaboration necessary to bring about these changes.

[3] "Zero default rate" means that all principal and interest was fully repaid. In cases where some portion of principal or interest was not fully repaid, many foundations were unable to report the amount of the default. Therefore, although we know the percent of loans that experienced some degree of default, we do not know how much of the loan may actually have been recovered. As a result, the actual losses incurred are likely to be less than the default rate.

INTRODUCTION TO MISSION INVESTING

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



Introduction to Mission Investing

If foundations are to achieve their lofty ambitions for social impact, they must find creative ways to use every resource they possess. One of the most innovative and powerful tools to have emerged in the field is a unique complement to traditional grantmaking that we refer to as mission investing.

Mission investing is the practice of using financial investments as tools to achieve a foundation's mission. Mission investing is a more specific type of social investing — the broader approach of considering social and environmental factors, whether or not directly related to mission, in investment decisions.

Mission investing is gaining momentum among US foundations. Recently, the use of mission investments, including program-related investments (PRIs), has been expanding rapidly. Mission investments' annual growth rate averaged 16.2% in the last five years, compared to just 2.9% during the preceding 32 years. Over the past decade, the number of foundations engaging in mission investing has doubled, and the new funds invested annually have tripled. Mission investments are also diversifying. Once largely restricted to low-interest loans, they now span a wide spectrum of debt and equity investments.

This study offers the first comprehensive look at the current and historical landscape of mission investing by US foundations. Funded by a grant from the David and Lucile Packard Foundation and guided by an Advisory Board of leading experts and practitioners, FSG Social Impact Advisors researched the mission investment practices of 92 US foundations that together have made $23 billion worth of mission investments.[4]

Although the foundations that participated in this study are all engaged in mission investing, many are still finding their way in this new sphere of activity.

Although the foundations that participated in this study are all engaged in mission investing, many are still finding their way in what is for most of them a relatively new sphere of activity. Most are unfamiliar with the spectrum of mission investment options and have not yet structured their operations to make and manage mission investments as efficiently as possible. Very few have fully incorporated mission investing into their organizational strategies. Outside the participants in our research, the vast majority of foundations have yet to explore the potential of mission investing. Our research suggests that a significant opportunity is now emerging for foundations to learn more about this approach for achieving their mission-driven goals and incorporate it as appropriate into their strategies and operating structures.

We were encouraged to find that most foundations we interviewed are interested in expanding their mission investment portfolios. We hope that this report provides foundations with a clearer understanding of investment activity to date as well as insights into how to launch or enhance their own mission investing programs.

Investing in Local Economic Development

After a series of corporate mergers and acquisitions challenged the local economy and reduced local corporate grantmaking, **Kalamazoo Community Foundation** had to take on a broader philanthropic role to foster economic development.

The foundation developed a coordinated strategy for making economic development grants, loans, and venture capital investments. It has made low-interest loans to a science company incubator, community/real estate development partnerships and housing organizations. Its venture capital holdings are in funds that make significant investments in Kalamazoo-based start-up companies.

To fund these mission investments, the board has allocated $18 million of unrestricted endowment funds, $5 million of which is dedicated to venture capital. Over 90% of the funds have been committed to date.

Not only do these mission investments support economic development in unique ways, but they stretch the foundation's philanthropic assets for further community development. Comments Wes Freeland, Advisor to the President/CEO of Kalamazoo Community Foundation: "If you had a goal that you could achieve with a grant or an investment, which would you choose? For us, the clear answer is that you would rather retain the assets and make an investment."

Project Methodology

This study had two phases: in-depth interviews and detailed data collection. In the first phase, we interviewed 92 foundations (64 private, 24 community and 4 corporate[5]), investigating their mission investing programs and approaches, their motivations, and the challenges they face. Over 60% of these foundations then provided detailed data on their current and historical mission investments.[6]

[4] In constant 2005 dollars based on annual average CPI of all urban consumers as reported by the US Department of Labor.
[5] The number of corporate participants is low because some targeted foundations declined to participate and several others fund their investments out of the corporation instead of the foundation.
[6] 39 private foundations, 17 corporate foundations, and 3 corporate foundations provided data on investments. Nearly all of the foundations that did not provide data cited a lack of staff available to gather the information requested.

The research provides a rich picture of US foundations' mission investment activities and performance. However, due to a lack of comprehensive record keeping and reporting on mission investments at many foundations and a shortage of foundation staff to research the data internally, much financial information was not available. Where appropriate, we note these gaps.

To encourage foundations to participate, we agreed to report our findings in the aggregate. We do not share details about individual investors, investees, or investment deals in this report unless we were given specific permission to disclose the information. With approval from participating foundations, FSG provided detailed data about most of the investments in this study to the PRI Makers Network to populate a database that will be available as a reference tool to its members. (See www.primakers.net for more information)

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 return.

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 foundations 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 studied are **program-related investments** (PRIs) made by private foundations. 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."[7]

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.

Examples of Foundation Mission Investing

- A foundation works with a local bank to guarantee low-interest student loans for local youths who otherwise have few education funding options. Using funds as a guarantee to secure a lower rate benefits significantly more students than if the foundation had awarded one-time scholarships with the same dollars.
- A foundation focused on environmental protection makes an early-stage direct investment in a private company that is developing technology for cleaner fuel usage.
- A foundation makes an investment in a certificate of deposit at a community development bank with the understanding that the funds will be used to provide loans to local businesses in order to spur economic development and job creation. The bank pays 1.5% interest to the foundation and charges 3.5% interest to the businesses, a below-market rate.

[7] IRS web site: http://www.irs.gov/charities/foundations/article/0,,id=137793,00.html

Until the mid-1990's, 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.

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."[8] 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.

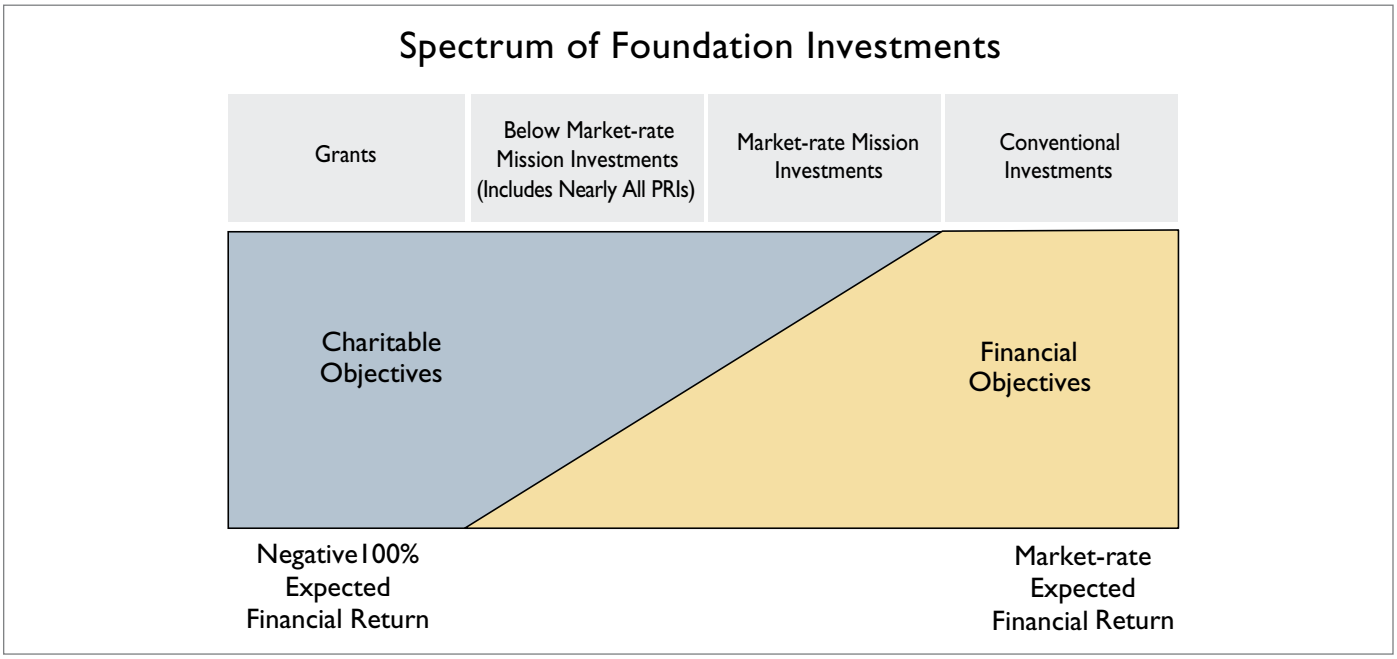
"Should a private foundation be more than a private investment company that uses some of its excess cash flow for charitable purposes?....The question above, answered in the affirmative by our Board, has shaped our thinking and practice."[9]
– Luther Ragin, Jr, The F.B. Heron Foundation

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 a need that a grant could not 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 grants cannot.

By taking the lead in new kinds of market-rate investments that are not yet addressed 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 returns to attract



[8] IRS web site: http://www.irs.gov/charities/foundations/article/0,,id=137793,00.html
[9] Ragin, Luther. "New Frontiers in Mission Investing." The F.B. Heron Foundation, 2004

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.[10] Negative screens do not, however, result in a particular mission investment. Positive screens, such as targeting companies that have strong environmental records, may yield as mission investments if the screening criteria are specifically tied to the foundation's mission. Otherwise, these screened investments are social investments but not mission investments.

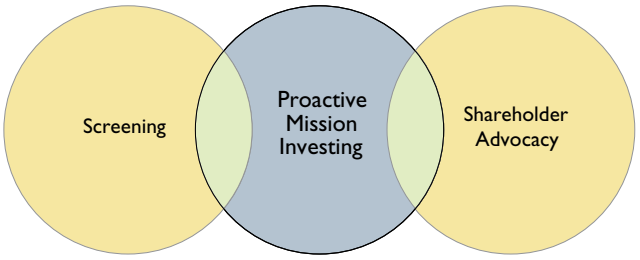
Although SRI funds are the most well known social investment vehicle, very few of the foundations studied have made such investments. Several noted that they previously held such investments but divested them because they did not see a clear connection to their missions, and the funds' performance was 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.[11]

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.[12] If foundations advocate on issues related to their core goals, the equity holding is a mission investment. Our definition of mission investments, however, focuses on whether the investment was *made with the intention* of achieving a mission-related objective. As a result, although we recognize the value of leveraging current stock holdings for advocacy efforts, we did not include investments that were not made with the intent of achieving mission-related purposes in the scope of this study. Although some of the foundations that participated in this study practiced shareholder advocacy with stocks they already owned, none bought stock in a company specifically for advocacy purposes

Proactive mission investing: The primary mission investing approach used by foundations studied is making proactive, targeted investments, either directly or through intermediaries. These investments are the focus of the study.

Mission Investment Approaches Used by Foundations



Leveraging Real Estate Investments

Hutton Foundation, a $75 million private foundation, has been making mission investments in addition to grants since its inception in 1997.

Leveraging the real estate expertise of its President, Tom Parker, the foundation started by making low-interest loans to local nonprofit organizations to buy buildings rather than pay escalating rents. Desiring an investment approach that could benefit multiple nonprofits at one time and recognizing that some organizations are too small to need an entire building, the foundation switched to buying and then renting out buildings at low rates to nonprofits. Other local foundations have since joined as partners in these investments.

Hutton Foundation has allocated a rolling 40% of its total assets to mission investing and has made mission investments totaling more than $29 million to date.

[10] 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.
[11] MacKerron, Conrad, Bauer, Doug. "Unlocking the Power of the Proxy." Rockefeller Philanthropy Advisors, As You Sow Foundation, 2004.; www.ceres.com
[12] There are strong examples of shareholder advocacy by foundations that did not participate in the study, particularly the Jessie Smith Noyes Foundation.

Direct investments are made directly by foundations to nonprofit organizations, social enterprises, and publicly or privately owned companies. They can take a range of forms, from a loan to help a nonprofit purchase a building to an investment in an early-stage private company that is developing an environmentally beneficial product. When making a direct mission investment, a foundation finds, selects, manages, and evaluates the investment itself.

Alternatively, foundations can invest in or through intermediaries that aggregate and distribute capital to individuals, organizations, or companies to achieve social benefits. Intermediaries can be nonprofit or for-profit organizations and can take many forms:

- Community development financial institutions (CDFIs), including:[13]
  - **Banks:** Financial institutions that provide capital to rebuild economically distressed communities through targeted lending and investing.
  - **Credit unions:** Non-profit financial cooperatives that provide affordable credit and retail financial services to low-income people, often with special outreach to minority communities.
  - **Loan funds:** Pools of capital that provide financing to businesses, organizations, and individuals in low-income communities.
  - **Bond funds:** Mutual funds that invest in fixed income securities supporting community development in low to moderate income areas.
  - **Venture capital funds:** Funds that provide equity to small- and medium-sized businesses in distressed communities.
- Non-community development investment funds, including:
  - **Microfinance debt and equity funds:** Funds that provide loans or equity to microfinance institutions.
  - **Public equity funds (screened funds):** Mutual funds of corporate securities assembled based on social or environmental criteria (positive or negative screens).
  - **Real estate funds:** Funds that invest in and develop real estate with a social or environmental purpose.

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.

[13] Several of these definitions were informed by the Community Investing Center, www.communityinvest.org

Although the foundations that participated in this study are all engaged in mission investing, many are still finding their way in this new sphere of activity.

Asset Classes

With the assistance of our Advisory Board, we identified 20 distinct asset classes of mission investments and were able to collect data on at least one investment in all but two categories (Other Asset Backed Securities and Direct Public Equity).[14] Depending on the terms, investments within each asset class can have either market-rate or below market-rate expected financial returns. Definitions of each asset class are provided in the Appendix.

Examples of Foundation Mission Investing

- A foundation invests in a bond issued by a development bank for rural cooperatives.
- A foundation focused on strengthening the local nonprofit sector purchases a building and rents space at below-market rates to nonprofit organizations.
- A foundation focused on environmental protection invests in a screened mutual fund that includes only companies with strong environmental records.

Mission Investment Asset Classes

Debt												
Conditional Investments		Deposits		Loans					Fixed Income Securities			
Loan Guarantee	Recoverable Grant	Insured Deposit	Linked Deposit	Senior Loan	Subordinated Loan	Line of Credit	Senior Loan Fund	Subordinated Loan Fund	Bond	Bond Fund	Mortgage Backed Security	Other Asset Backed Security

Equity						
Real Estate		Public Equity		Private Equity		
Real Estate (individual investments)	Real Estate Fund	Public Equity Fund (includes SRI Funds)	Direct Public Equity (individual companies)	Direct Private Equity (individual companies)	Private Equity Fund	Venture Capital Fund

Notes: This study collected data on at least one investment in each of these asset classes except Other Asset Backed Securities and Direct Public Equity. See the Appendix for definitions of each asset class.

[14] In our analysis, we combined senior loans and subordinated loans into one loan category because many foundations did not specify the seniority level of their loan investments.

Developing a Mission Investing Strategy

Meyer Memorial Trust, a $625 million private foundation in Oregon, has been making below market-rate mission investments (primarily PRIs) for over 20 years. For most of this period, the foundation made investments opportunistically based on community needs. However, in January of 2003, the Trust contracted an MBA student to research and prepare a white paper on mission investments, with a focus on PRI market leaders and an analysis of the opportunities and challenges in executing a more intentional PRI program. This research provided Meyer Trust leadership the knowledge base to present a compelling case for formalizing its PRI program, which was approved by the Meyer Trustees in January 2004. Since that time the program has grown rapidly and gained favor with Meyer Trustees following the allocation of dedicated staff, Ann Lininger, who focuses on PRIs and other mission investments. Ann works with Wayne Pierson, the Trust's CFO, and outside consultants as needed to structure and manage these investments.

Since 1984, the Meyer Trust has approved nearly 30 PRIs totaling $16 million in investments to support projects related to economic development, affordable housing, community facilities development, environmental protection, and the arts. Nonprofit recipients have used PRI funds to start social business ventures, capitalize lending intermediaries, pay construction costs, buy land, and retire conventional mortgage debt.

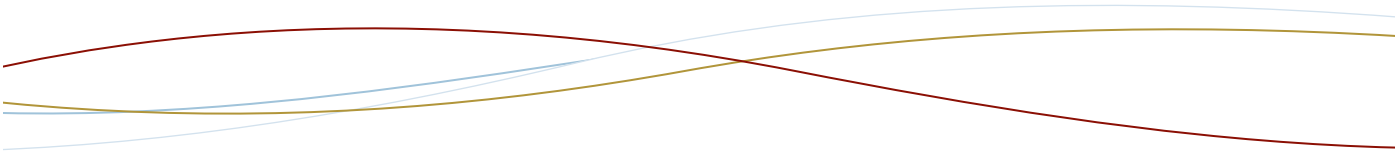
Meyer Memorial Trust's mission investments include both debt and equity: senior and subordinated loans, recoverable grants, subordinated loan funds, venture capital funds and direct private equity. The debt investments (all PRIs) were funded with program dollars and the equity investments with endowment funds.

Building on its past, the Meyer Trust is currently developing a new philanthropic and organizational strategy and is including PRIs as an important strategic approach for achieving its goals, particularly in affordable housing.

Building on its past, the Meyer Trust is currently developing a new philanthropic and organizational strategy and is including PRIs as an important strategic approach for achieving its goals, particularly in affordable housing.

TRENDS IN MISSION INVESTING

Over the past decade, the number of foundations engaged in mission investing has doubled and the amount of new funds invested annually has tripled.



Trends in Mission Investing

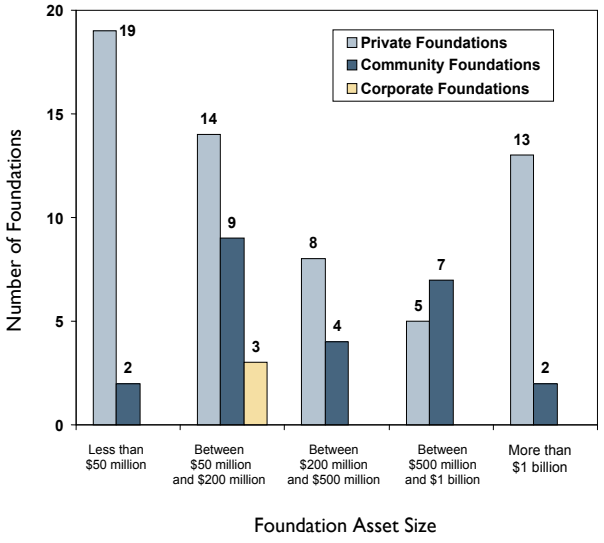
Several large private foundations pioneered mission investing with **program-related investments** (PRIs) in the late 1960s and early 1970s, but few other foundations followed their lead until the mid-1990s, when interest in mission investments burgeoned. Since 1995, mission investments have enjoyed especially strong growth, with substantial increases in both the number of foundations participating and the dollars invested. All types of foundations in the US are now engaging in mission investing, with private independent foundations leading the growth.

In our research, we often encountered the misconception that mission investments are made only by very large foundations that can set aside significant funds. However, our research shows that foundations of all sizes are making mission investments, even if on a small scale. Thirty percent of all private foundations making mission investments in our study have assets totaling less than $50 million, and 9% have less than $10 million in assets.

All types of foundations in the US are now engaging in mission investing, with private independent foundations leading the growth.

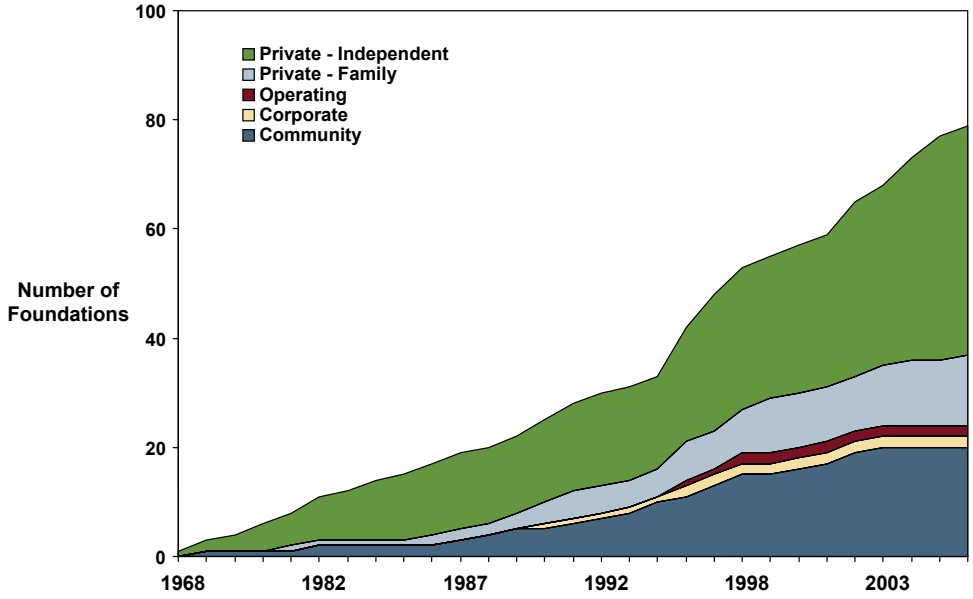
Our research shows that foundations of all sizes are making mission investments, even if on a small scale. Thirty percent of all private foundations making mission investments have assets totaling less than $50 million, and 9% have less than $10 million in assets.

Number of Foundations Making Mission Investments by Type



Notes: Asset size was not available for 5 private foundations and 1 corporate foundation so they are not included in this analysis.

Number of Foundations Making Mission Investments



Notes: The first year of mission investing was not available for 13 of the 92 foundations studied–they therefore are not included in this analysis.

19 Open mission investments are investments that have been made, and have not yet either been fully repaid or written off as a loss.
20 This total reflects the amount committed at the time of investment. It does not equal the amount outstanding because some of the committed investment amounts have been repaid. However, since total outstanding amounts were unavailable, we use this as a proxy.

Along with the growth in participation has come a strong, if irregular, expansion in the total amount of foundation money going into mission investments. The compound annual growth rate (CAGR) of mission investment dollars was 16.2% from 2000 to 2005. During the preceding 32 years, the CAGR was only 2.9%.

Though foundations of all sizes are making mission investments, bigger foundations tend to have both a larger number of mission investments and more funds invested. Their mission investment portfolios nevertheless represent an extremely small percentage of their overall assets.

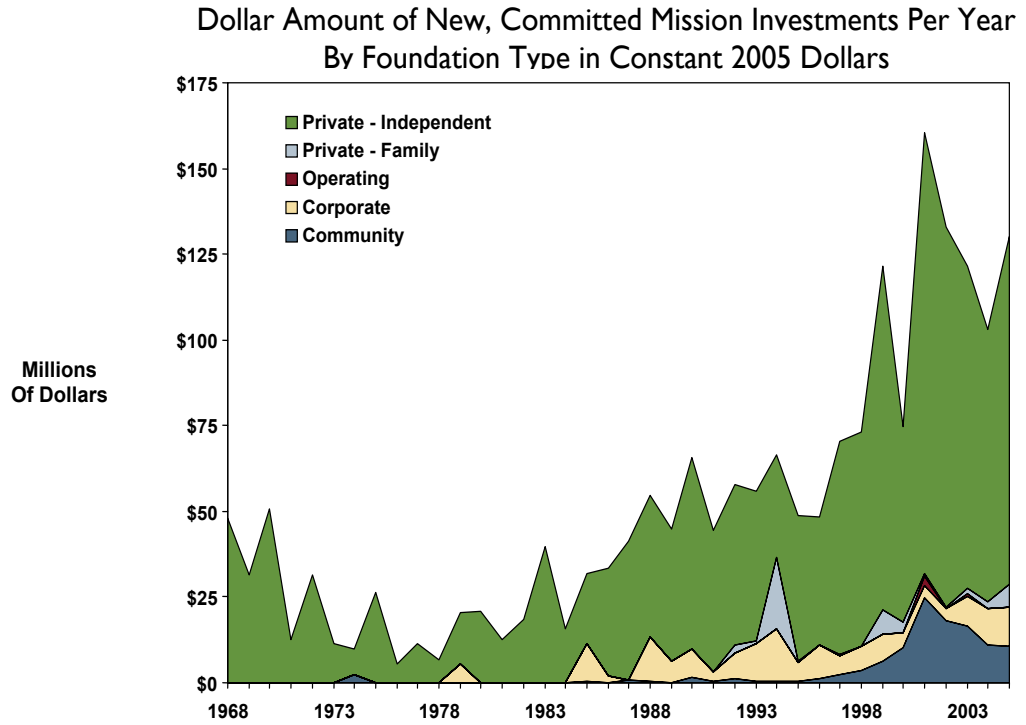
Participation in mission investing varies by foundation type. Community foundations and private foundations have the same median number of investments in their portfolios, but the average community foundation investment is much smaller. As a result, the value of the median private foundation mission investment portfolio is considerably larger than that of the median community foundation portfolio.

Open Mission Investment Portfolios By Foundation Asset Size as of Dec 2005 [15]

	Up to $50 million	$50-200 million	$200-500 million	$500 million-$1billion	>$1 billion
Median Number of Open Mission Investments per Foundation	1	4	13	3	19
Median Total Committed Value of Open Mission Investments per Foundation	$0.4 million	$2.0 million	$9.4 million	$1.1 million	$19.4 million

Open Mission Investment Portfolios By Foundation Type as of December 2005 [15]

	Community Foundations	Corporate Foundations	All Private Foundations
Median Number of Open Mission Investments per Foundation	4	13	4
Median Total Committed Value of Open Mission Investments per Foundation	$1.5 million	$5.7 million	$2.8 million



Notes: 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 investments, one foundation's infrequent and large equity investments are not included in this trend analysis. The first year of mission investing or the foundation size was not available for $120 million of investments – they, therefore, are not included in this analysis.

[15] Open mission investments are investments that have been made, and have not yet either been fully repaid or written off as a loss. This total reflects the amount committed at the time of investment for investments that have not yet completed. It does not equal the amount outstanding because some of the committed investment amounts have been repaid. However, since total outstanding amounts were unavailable, we use this as a proxy.

The PRI programs of four large foundations (the Ford Foundation, the David and Lucile Packard Foundation, the John D. and Catherine T. MacArthur Foundation, and one anonymous foundation) together account for most historical US mission investment activity. In recent years, however, mission investing by smaller foundations has grown rapidly. Smaller foundations accounted for 44% of all new mission investment dollars in 2005, representing an annual growth rate of 22% over the past five years, compared to a 13% growth rate for the most active four foundations. The fastest growth in participation has been among foundations with assets under $200 million.

Investment Type

Although they have historically concentrated their mission investments in loans, foundations have begun making a wide variety of other investments, both debt and equity.

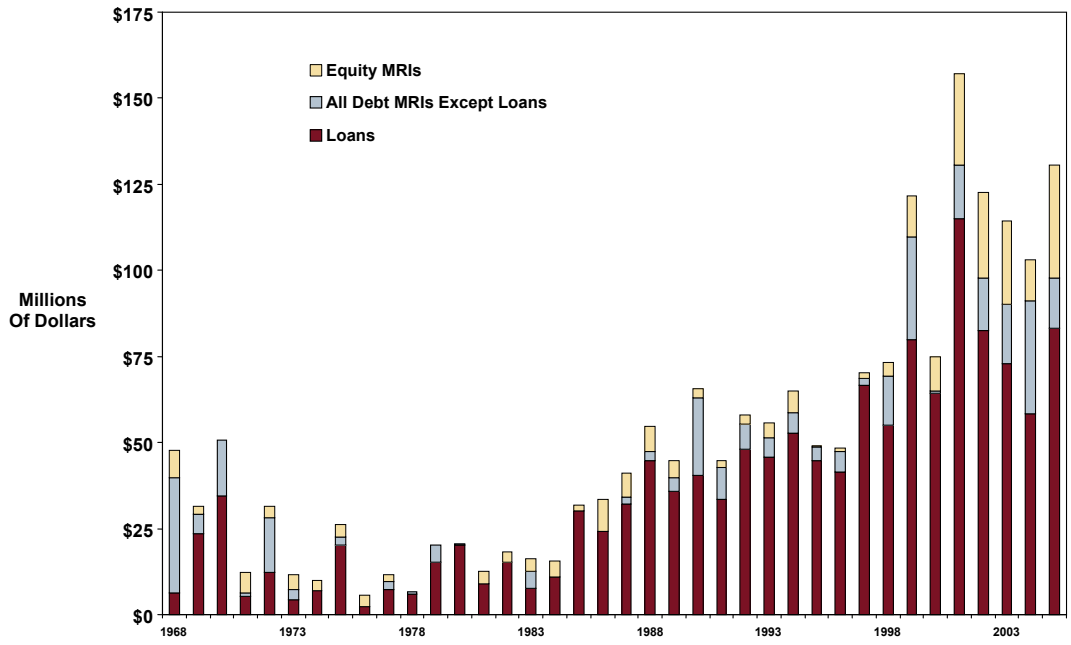
Foundations have concentrated their non-loan debt investments in loan guarantees, loan funds and insured deposits. Insured deposits are becoming particularly popular. They represent over 10% of new mission investments, though due to their small average size they account for only 1% of funds invested in mission investments in the last five years.[16]

Equity investments over the past half decade among the studied foundations have been concentrated in venture capital funds and real estate investments (almost entirely driven by the large real estate deals of one foundation).

Although loans are the most common investment type for PRIs, our research found that private foundations are making a wide variety of program-related investments, both debt and equity. We found PRIs in all debt asset classes except bond funds, mortgage backed securities and other asset backed securities and all equity asset classes except public equity investments.

Although they have historically concentrated their mission investments in loans, foundations have begun making a wide variety of other investments, both debt and equity

Total Dollar Value of New Committed Mission Investments Per Year By Type



Notes: In constant 2005 dollars based on annual average CPI, all urban consumers as reported by the US Dept of Labor. 13% of all investments studied did not have available start dates or specified asset classes so these investments were not included in this analysis. To avoid skewing the trend data, one foundation's few, large equity investments were not included.

[16] The number of insured deposits may be impacted by the FDIC insured limit of $100 thousand per deposit. Some foundations may break up a larger investment into several deposits in order to qualify for FDIC insurance.

Interestingly, the diversity of mission investment investments varies widely by foundation size. Foundations with assets between $200M and $500M exhibited the most diversity, with 62% of their mission investments going to asset classes other than loans. In contrast, foundations with more than $1B in assets put only 22% of their mission investments into non-loan classes. Although very large foundations were the pioneers in mission investing, they have been relatively slow to diversify beyond loans.

Apart from loans, foundations have concentrated their recent debt activity in loan guarantees, loan funds and insured deposits.

Mission Investments By Asset Class,
All Mission Investments Made 2001-2005

Asset Class	Total Dollar Amount Committed $889.2 million	Total Number of Investments 520 Mission Investments
Debt		
Loan	43.7%	63.1%
Loan Guarantee	6.2%	1.9%
Loan Fund	1.1%	3.3%
Fixed Income Fund	1.0%	0.8%
Insured Deposit	1.0%	10.4%
Linked Deposit	0.4%	0.2%
Line of Credit	0.4%	1.3%
Recoverable Grant	0.1%	0.6%
Debt Total	53.9%	81.5%
Equity		
Real Estate – individual investments	36.2%	5.2%
Venture Capital Fund	3.0%	4.6%
Private Equity Fund	2.0%	1.7%
Public Equity Fund	1.9%	1.0%
Direct Private Equity	1.7%	1.7%
Real Estate Fund	0.2%	0.2%
Equity Total	45.0%	14.4%
Asset Class Not Available	1.1%	4.0%
Grand Total	100.0%	100.0%

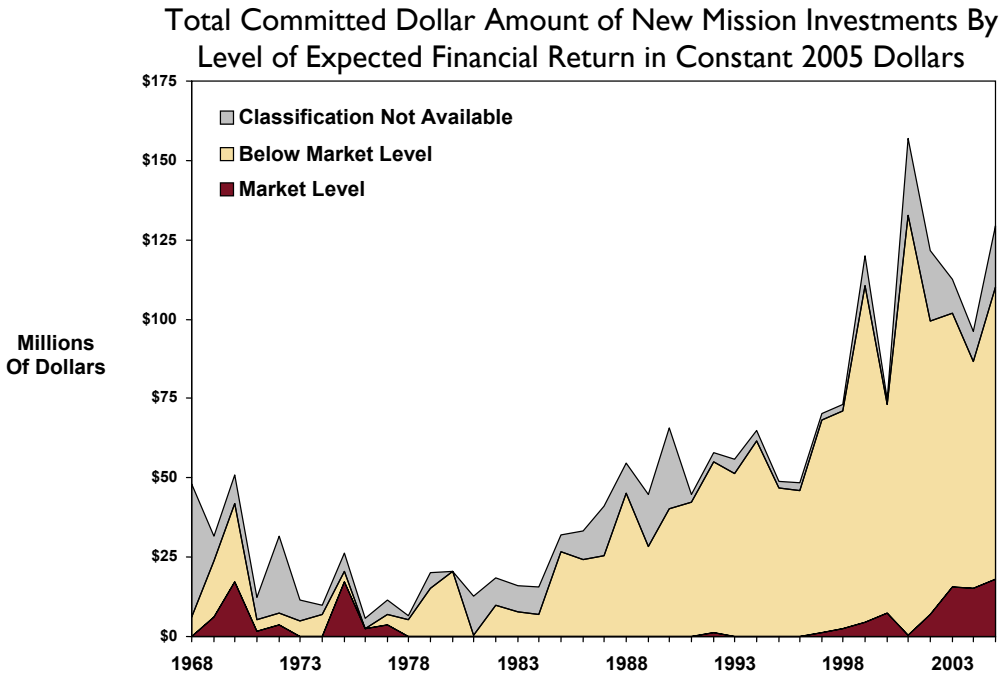
In addition to utilizing a wider range of investment types, foundations are increasingly investing in market-rate mission investments. In 2005, market-rate investments accounted for 11% of all mission investments, having grown at a 19.5% compound annual rate since 2000.[17] In contrast, below market-rate mission investments grew by only 7% annually during this period.

In addition to utilizing a wider range of investment types, foundations are increasingly investing in market-rate mission investments.

Most of the new market-rate mission investments are loans and insured deposits, although modest amounts of investment are going into fixed income funds, real estate funds, and equity funds. The rapid increase in market-rate loans is particularly remarkable. Of all loans made before 2000, only 4% had market-level interest rates. From 2000 to 2005, 12% of loans were made at market rates.

Looking at the breakdown of expected financial returns by asset class over the past half-decade, there are clear patterns by mission investment type. From 2000 to 2005, the expected returns for market-rate loans and lines of credit were about 3% higher than their below-market peers, a slightly smaller differential than in previous years. The difference between market-rate and below market-rate returns was more pronounced in private equity funds, with a 10% differential. Due to major market-rate swings for fixed income funds during this period, investments classified as market-rate in one year could fall below market rate in another, resulting in the unexpected finding that average returns were sometimes higher for below-market rate mission investments than for market-rate ones.

It is important to remember that the expected returns of loans, lines of credit, and recoverable grants are set by the foundations, and that many foundations have deliberately chosen to set them at extremely low rates. Therefore, expected returns for these asset classes do not necessarily reflect the highest possible financial returns.

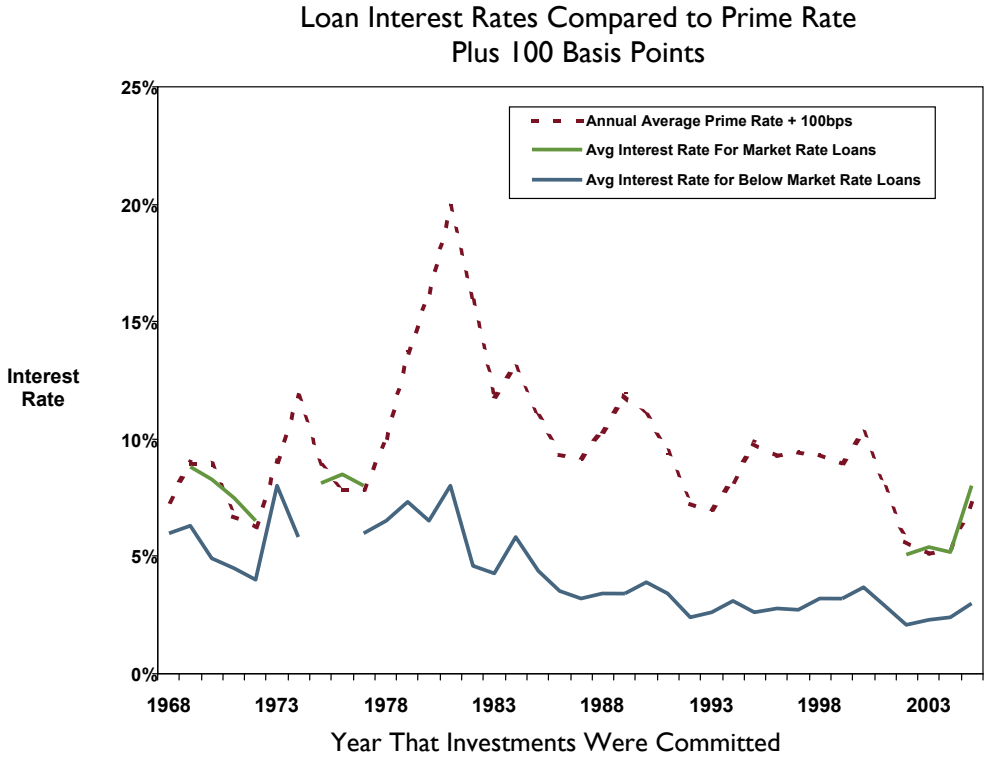


Notes: In constant 2005 dollars based on annual average CPI, all urban consumers as reported by the US Dept of Labor. To avoid major swings due to periodic large investments, one foundation's infrequent and large equity investments (all Below Market Mission Investments) are not included in this trend analysis. $201M of Social Investments were made in 2006 or had unavailable years so they are not included in this analysis.

[17] We classified each mission investment as having Market-rate or Below Market-rate expected financial returns based on conservative annual average benchmarks for each asset class for the year in which each investment was made. Loans: Prime+100 bps; Fixed income: Lehman Brothers Aggregate Bond Index; Private equity and venture capital: Russell 3000+300bps; Insured Deposits: Federal Reserve annual CD rates; Real Estate (indiv): commercial mortgage rates

Asset Class		Expected Financial Returns of All Mission Investments Made 2000-2005				
		Market Rate Mission Investments		Below Market Rate Mission Investments		Unclassified MRIs
		Mean	# of MRIs	Mean	# of MRIs	# of MRIs
DEBT	Fixed Income - Indiv	-	-	-	-	-
	Fixed Income Fund	5.0%	2	8.3%	1	1
	Insured Deposit	3.6%	49	3.7%	6	-
	Line of Credit	6.6%	1	3.5%	3	3
	Linked Deposit	-	-	2.5%	2	-
	Loan	5.3%	45	2.8%	309	27
	Loan Fund	-	-	2.3%	17	-
	Loan Guarantee	-	-	0.0%	8	-
	Mortgage Backed	-	-	-	-	-
	Recoverable Grant	-	-	0.2%	2	1
EQUITY	Direct Private Equity	-	-	1.8%	4	7
	Private Equity Fund	20.0	2	11.4	7	1
	Public Equity Fund	8.0%	1	-	-	4
	Real Estate	-	-	0.8%	4	23
	Real Estate Fund	15.0	3	-	-	1
	Venture Capital Fund	-	-	7.8%	13	12

Notes: Mission Investments are not included in this analysis because they either did not have a specified asset class or a specified year of investment.



Source: Federal Reserve web site

Investee Type

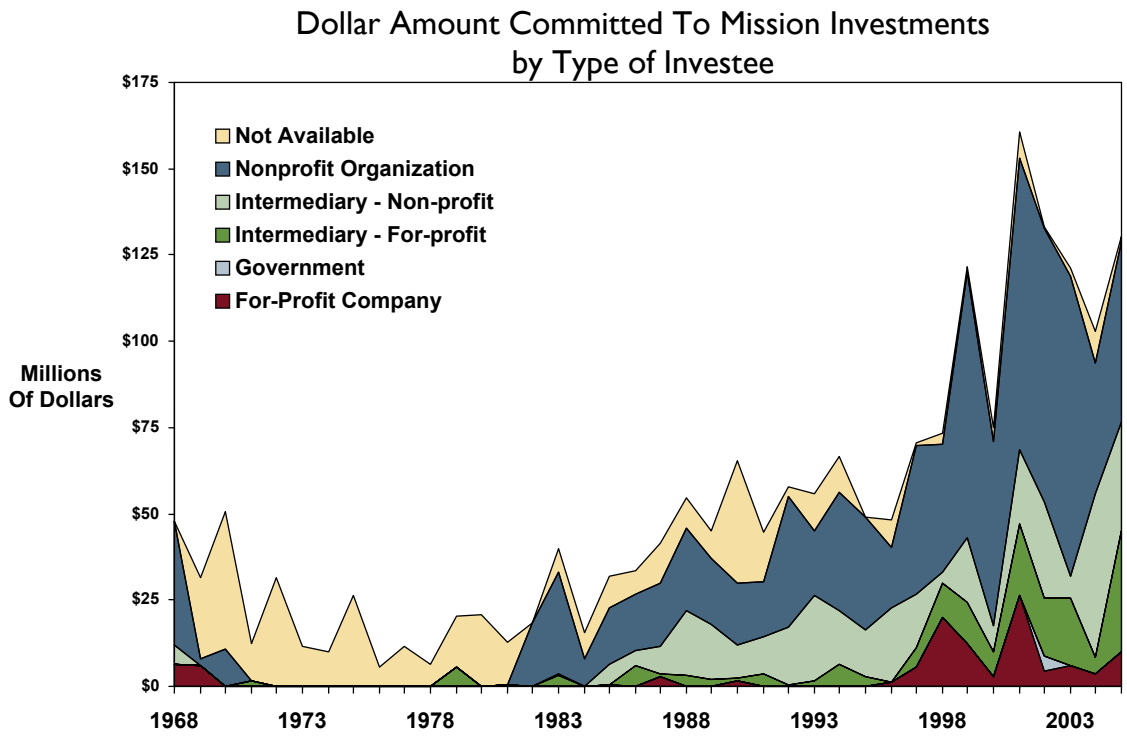
Most mission investment dollars have been loaned directly to nonprofit organizations, although foundations have recently begun channeling more of their funds through nonprofit and for-profit intermediaries. With loans to nonprofit organizations, foundations often lend to their own grantees and therefore have a pipeline of potential borrowers. As foundations invest in other asset classes, however, they lack an adequate deal flow and increasingly rely on intermediaries.

Investment intermediaries offer several potential advantages:

- ***Reduced financial risk:*** By investing in a pool of investments rather than one direct investment, a foundation can spread and lower its risk.
- ***Lower transaction costs and greater expertise:*** Intermediaries structure their operations and staff to make and manage investments in the most efficient and effective manner possible. Their expertise also helps to select investments that are less likely to end in default. In contrast, most foundations do not yet have staff with the time and expertise to handle mission investments.

"Historically, we made a lot of direct investments to organizations but that's not the case now. Most of our losses came from there. We tend to try to invest through intermediaries now," – Private Foundation

- ***Increased deal flow and size:*** Many foundations, particularly those new to mission investing, have difficulty finding investment opportunities. By working with an intermediary that has developed a steady deal flow, a foundation can expand its potential investments and also participate in larger-scale deals than it could afford on its own.
- ***Superior reporting:*** Because investment intermediaries manage numerous investments, they are in a unique position to report on the aggregate financial and social performance of mission investments.
- ***Reduced reputational risk:*** If an investee defaults on a loan or otherwise fails to fulfill the terms of an investment,



Notes: 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.

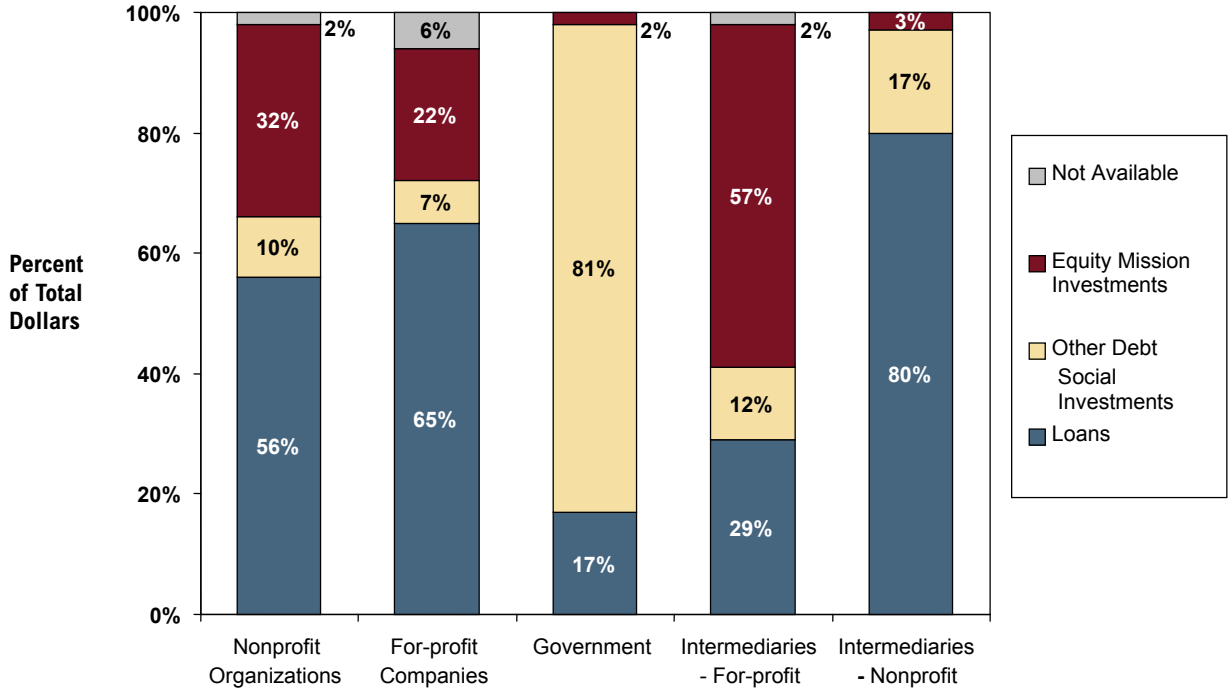
The kinds of investments foundations make vary by the type of investee. Investments in nonprofit organizations are primarily loans.[18] For-profit companies also receive the majority of their funds via loans, but roughly a fifth of their mission investment dollars come through direct private equity investments. Mission investments in government are primarily in municipal bonds.

By investing in a pool of investments rather than one direct investment, a foundation can spread and lower the risk.

Examples of Foundation Mission Investing

- A foundation focused on addressing a major disease invests in an early-stage private biotechnology company conducting research on potential cures.
- A foundation makes a below-market rate loan to a childcare center to enable it to purchase a building instead of continuing to pay rising rents.
- A foundation with an environmental protection mission purchases shares of a company with a record of poor environmental practices in order to advocate as a shareholder for new environmentally responsible business practices.

Dollar Amount Committed To Mission Investments by Type of Investee
All Mission Investments Studied (1968-2006)



Notes: Equity investments for nonprofit organizations are real estate investments that the foundation holds for the benefit of the nonprofit. Traditional equity investments are not possible with nonprofit organizations because they cannot sell shares of ownership.

[18] About a third of the total dollars invested in nonprofits take the form of equity investments in real estate, but those investments come primarily from a single foundation. Nonprofit organizations cannot receive traditional equity investments because they cannot sell an ownership share of their organizations.

Investment Size

Mission investments can be made in a surprisingly wide range of amounts, making them a highly flexible tool for foundations. Our research identified some mission investments as small as $1,000 and others larger than $75 million.

Mission investments can be made in a surprisingly wide range of amounts, making them a highly flexible tool for foundations.

Foundations should keep in mind, however, that a similar amount of work is often required for a small investment as for a large one. As each investment requires staff time for sourcing, due diligence, and management, making fewer large investments is a more cost-effective use of limited staff resources. That's especially true for direct investments, which are particularly labor-intensive.

"Some of our mission investments are so small they're painful, a million dollars or so. We'd rather do something much larger." – Corporate Foundation

In recognition of the cost issues, mission investments tend to be much larger than grants. The Center for Effective Philanthropy found that median program support grants are $60,000 and median operating support grants are $50,000, while the median investment size for nearly all mission investment asset classes is over $500,000.[19]

Mission Investment Asset Sizes
All Mission Investments Studied 1968-2006

Type	Asset Class	Investment Size ($ thousand)		
		Minimum	Maximum	Median
Debt	Linked Deposit	$700	$4,000	$3,250
	Bond Fund	$500	$3,808	$2,391
	Loan Guarantee	$25	$19,000	$1,000
	Line of Credit	$100	$1,600	$625
	Bond	$100	$5,000	$550
	Loan	$1	$15,000	$500
	Loan Fund	$50	$3,750	$500
	Insured Deposit - including CDs	$100	$1,000	$100
	Recoverable Grant	$8	$1,000	$47
Equity	Real Estate - individual investments	$331	$78,450	$2,900
	Private Equity Fund	$200	$3,804	$2,000
	Public Equity Fund	$1,500	$10,000	$1,806
	Real Estate Fund	$1,000	$3,000	$1,250
	Venture Capital Fund	$20	$5,000	$875
	Direct Private Equity - individual	$4	$3,600	$50

[19] Huang, Judy, Buchanan, Phil, and Buteau, Ellie. "In Search of Impact: Practices and Perceptions in Foundations' Provision of Program and Operating Grants to Nonprofits." The Center for Effective Philanthropy. 2006.

Investment Duration

As with any investment, foundations must consider the time that their funds will be committed to a mission investment and hence unavailable for other purposes. In general, debt mission investments have shorter average expected timeframes than their equity counterparts. Debt mission investments also tend to have fixed repayment schedules, making their timing more predictable than equity investments.

Depending on market conditions and performance, private equity and real estate investments may be difficult to sell at the time a foundation desires to recycle the funds. As a result, foundations should think carefully about their investment horizons, their exit options, and the liquidity risk of not being able to sell an investment at a given time.

Average Expected Duration of Investment
All Mission Investments Studied 1968-2006

Average in years	Debt Investments	Equity Investments
3-4	Insured Deposit	-
4-5	Loan Fund	-
5-6	Bond Fund Line of Credit Loan Guarantee	-
6-7	-	-
7-8	Loan	Real Estate Fund
8-9	-	-
9-10	-	-
10-11	Linked Deposit	Private Equity Fund Direct Private Equity Venture Capital Fund
>11	Recoverable Grant (15 years)	Real Estate – individual investments (23 years)

Pioneering Comprehensive Mission Investing

The F.B. Heron Foundation, a $308 million private foundation, is a true mission investing pioneer. Led by the efforts of Luther Ragin, Jr., its Vice President of Investments, the foundation has allocated 24% of its assets to a wide spectrum of market-rate and below market-rate mission investments. Since the late 1990s, the foundation has invested in all of the asset classes we studied except for loan guarantees and individual real estate investments. No other foundation that we studied has invested so broadly.

As it has committed significant endowment funds to mission investing, the F.B. Heron Foundation has a strong focus on market-rate mission investments. About 73% of its mission investments have market-level expected returns. Continuing to break new ground, the foundation is experimenting with new types of mission investments. It is, for example, investing in public equity funds that use customized positive screens closely tied to its mission.

The F.B. Heron Foundation's strategic, comprehensive approach to mission investing is especially noteworthy. Mission investments are used as value creation tools by both finance and program staff, and the foundation has established clear benchmarks for financial performance for each mission investment asset class and type.

"The construction of a mission-related portfolio requires a commitment to bring an investment discipline to all aspects of our work."

– Luther Ragin, Jr.
Vice President of Investments

Mission Investment Performance

Sufficient Performance Data Is Only Available for Loans

Although we know the *expected* financial returns for each asset class of mission investments, we can only currently analyze the *actual* returns achieved for loans. As the vast majority of foundation mission investments made before 2000 were loans, nearly all of the investments that have matured and completed are in this asset class. We do not yet have sufficient data to analyze trends in the financial performance of other mission investment asset classes.

Financial Performance of Loans – Default Rates

Of the 28 foundations with completed loans in our study, 75% achieved a zero default rate on loans totaling over $230 million.[20] The other quarter of foundations had at least one loan that experienced some level of default ranging from full loss of principal and interest to loss of one interest payment. The defaulted loans were concentrated in three of these foundations, each of which has a cumulative loan-portfolio default rate of over 30%.

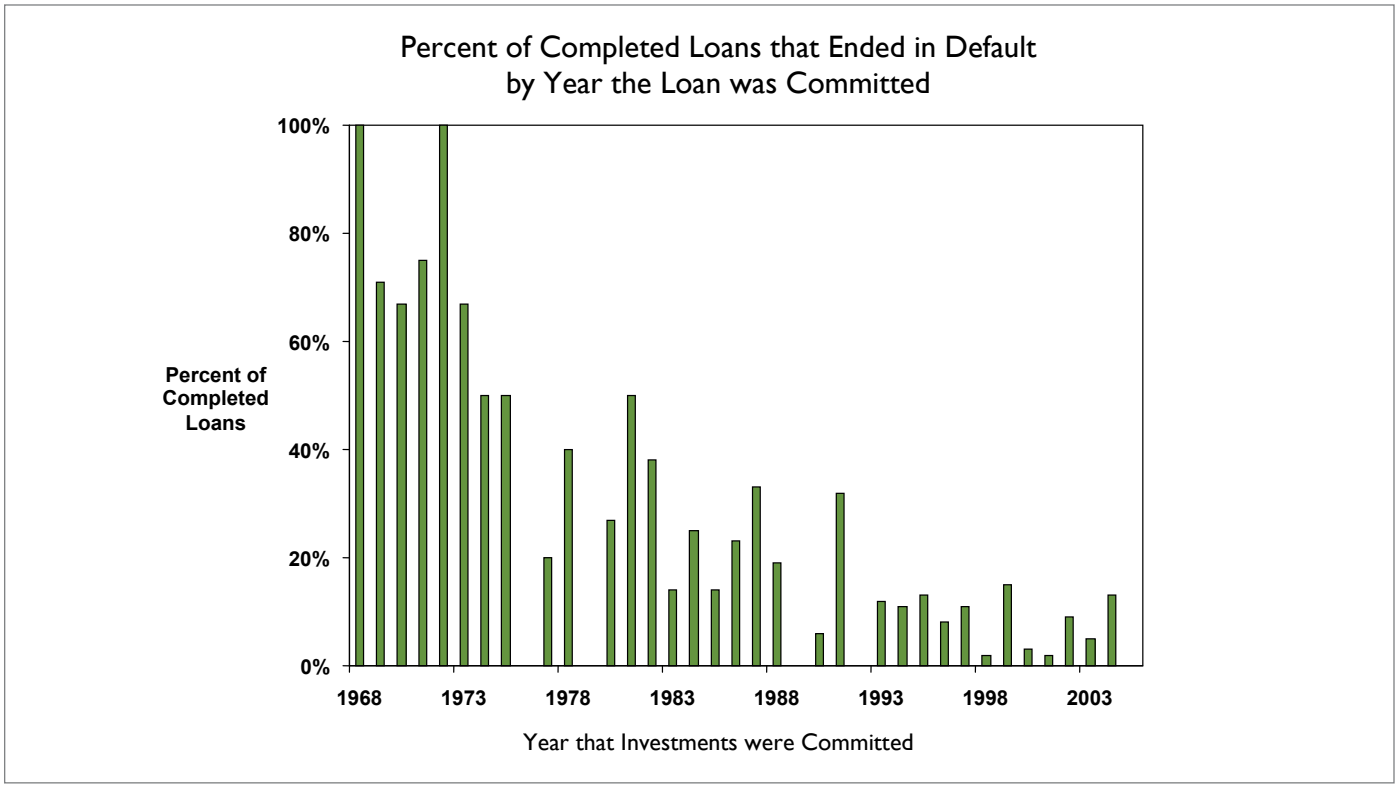
It is important to note that, due to incomplete records and lack of staff resources to research the information, many foundations were not able to quantify the losses for these defaulted loans. As a result, although we know the percentage of loans that experienced some level of term default rate, we can't analyze the extent. Therefore, "default" as used here may overstate the "loss rate".

In total, of the 653 completed loans in our study, 85% were fully repaid. Without the three foundations that had high default rates, the aggregate repayment rate is 96%.

The defaults that did occur may have resulted from the way that some foundations approach mission investing. Certain foundations purposefully fund highly experimental program models and are willing to shoulder a greater risk of default. As a result, they don't tend to be rigorous in their due diligence or persistent in their collection efforts. Others simply admit that they have made mistakes in their investments, particularly with their early attempts. Just as with any new approach, it takes time and experience for a foundation to become proficient in mission investing. As a Ford Foundation program officer noted in the foundation's own retrospective on its first two decades of making PRIs, "Many of our early losses were with types of ventures that, in retrospect, we probably had no business being in because we didn't know the field."[21]

Borrower type seems to have some correlation with loan default rates. Nonprofit organizations have the lowest default rate at 9.5% while for-profit companies' default rate is much higher at 19.4%. The default rates for nonprofit intermediaries and for-profit intermediaries are closer to the low end of the spectrum at 10.1% and 12.5%, respectively. A loan's interest rate also seems to have some correlation with defaults, with higher rates linked to a higher likelihood of problems.

It is encouraging to note that the percentage of loans with some level of default has decreased dramatically over time. The improvement in performance may indicate that foundations are learning, from their own experience and from one another, how to select appropriate borrowers and how to successfully manage and collect loans.



[20] For the purposes of this study, "default" means that some portion of the principal or agreed-upon interest was not repaid.
[21] Investing for Social Gain: Reflections on Two Decades of Program-Related Investments, Ford Foundation, 1991.

Loan Interest Rate	Default Rate For Loans With Such Interest Rates
0.0%	6.5%
0-2.9%	9.8%
3-4.9%	19.0%
5-6.9%	12%
7% and greater	31%

Financial Performance of Loans – Returns Achieved

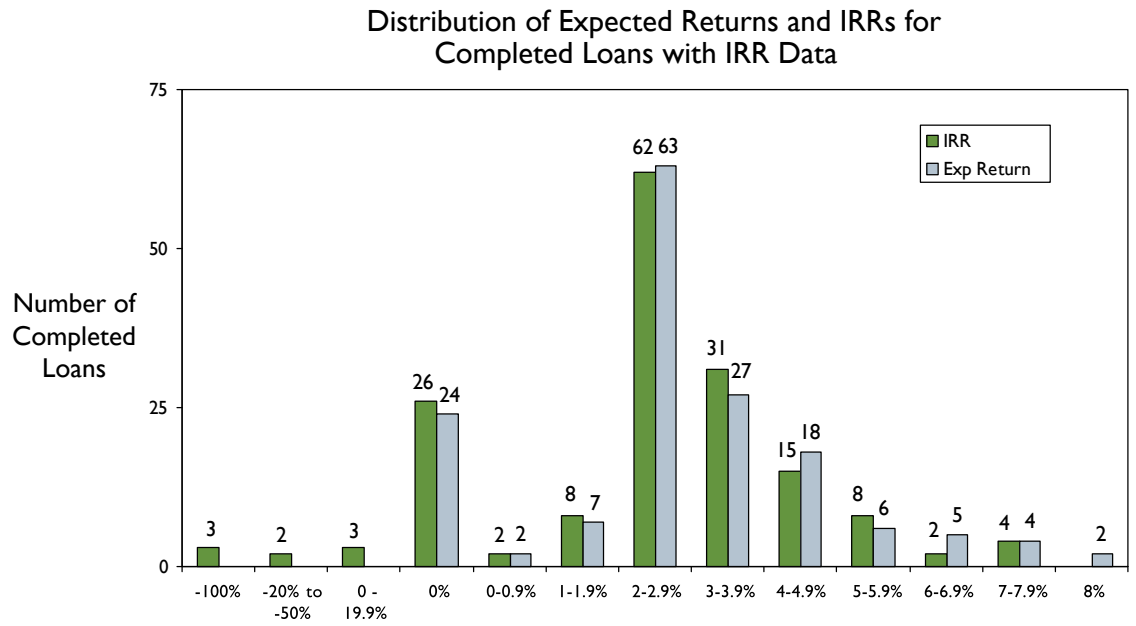
To determine actual returns of completed mission investments, we collected data on the cash flows of each investment, enabling us to calculate their internal rates of return (IRR). Due to a lack of data from most foundations, sufficient information was available to analyze only 18% of completed loans, totaling $183 million.

The available data does indicate some interesting trends. Other than several default outliers, the calculated IRRs closely track expected returns. Ninety percent of these loans fully met their financial return expectations. It is important to note that the foundations that furnished sufficient information to calculate IRRs for their completed loans were able to do so because they, unlike many foundations we studied, closely track their mission investments. The rigor they apply to tracking was also often evident in how they source and manage their mission investments. It is likely that their approach was a factor in achieving successful returns.

Financial Performance of Other Asset Classes

Although we are not able to assess trends on financial returns for mission investments other than loans, external performance benchmarks for some asset classes can provide a sense of the results achieved by other social investors.

- ***Private Equity/Venture Capital***
  - Community development venture capital is relatively new and most investments are still open. However, the Community Development Venture Capital Alliance (CDVCA) has analyzed early returns on the few CDVC funds that have closed and found that they achieved a 15.5% gross internal rate of return.[22]
  - McKinsey & Company studied direct private equity investments made by members of Investors' Circle, a US-based network of socially responsible angel investors over a ten-year period and found returns of 8% to 14%.[23]
- ***Public Equity Funds (screened funds)***
  - Several studies have found that social screening in SRI mutual funds does not harm long-term financial performance and may actually improve returns.[24]



Note: This distribution reflects the IRRs achieved by 18% of completed Loans. Due to lack of sufficient cash flow and/or payment data, IRRs for remaining completed loans is unavailable. Eight of these Loans did not have available Expected Returns available so those data points are not included.

[22] Community Development Financial Institutions: Providing Capital, Building Communities, Creating Impact; The CDFI Data Project; 2004
[23] Carden, Steven D. and Darragh, Olive; "A Halo For Angel Investors", The McKinsey Quarterly, 2004 Number 1
[24] Van de Velde, Vermeir, Corten; "Sustainable and Responsible Performance", The Journal of Investing, Fall 2005; Kurtz, Lloyd, "Answers to Four Questions", The Journal of Investing, Fall 2005

Room for Growth

Even with the strong recent expansion of mission investing, foundation portfolios of open mission investments represent a very small percentage of their total assets.

Most foundations are not yet harnessing the power of the vast majority of their assets for mission-related purposes.

When considering the total percentage of assets allocated to grants and mission investments, it becomes clear that most foundations are not yet harnessing the power of the vast majority of their assets for mission-related purposes.

Allocation of Foundation Assets to Mission-Related Activities (Not Including Operations/Staff Expenses)			
Activity Type	Community Foundations	Corporate Foundations	Private Foundations
Grants [25]	7.5%	20.6%	5.6%
Open Mission Investments [26]	8.7%	8.1% [27]	2.6%
Total	1.2%	28.7%	8.2%

"The first step is to recognize that foundations are not simply vehicles for distribution of charitable gifts, but rather investors in value creation."
– Jed Emerson[28]

Community Debt Investing

Barberton Community Foundation, a $99 million community foundation in Ohio, has a community investing program of below market-rate mission investments focused on local economic and neighborhood development.

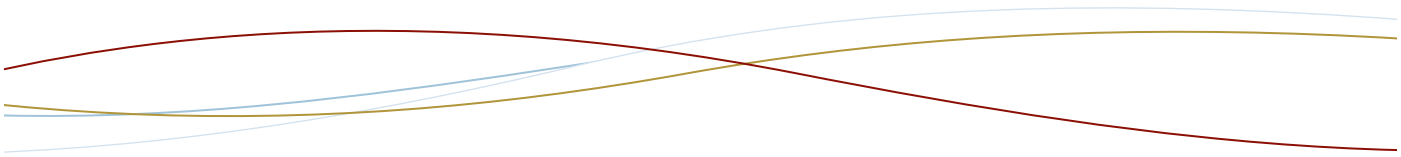
- The Foundation invests in *linked deposits* at local banks so that the banks will provide low-interest loans to a) local businesses in order to support economic development and job creation and b) homeowners for improvements to single-family, owner-occupied homes.
- Working with The Barberton Community Development Corporation Program (BCDC Program), the Foundation invests in BCDC and they in turn provide *loans* to companies to help them move to or expand in Barberton. According to the Foundation, this has resulted in 630 jobs created or retained with an annual payroll of $12.1 million. More than $12.6 million in plants and equipment has been invested. The benefits to the schools and city are estimated to be nearly $250,000 in annual city income and property tax revenues;
- Investment in a *loan fund,* administered by a local non-profit, that provides capital to first-time homebuyers and homeowners with home improvements. This program is limited to families at or below 130% of the median income level of the county.

With strong board support, the Foundation has allocated $8 million of foundation-directed funds for these investments. Management of these investments is shared by the Foundation's Controller and the Director of Grants and Scholarships.

[25] The Foundation Center FC Stats, 2004. Grantmaking includes grants, scholarships, and employee matching gifts. These figures are from a sector-wide analysis, not just the foundations participating in this study. They are provided for reference by foundation type.
[26] Open mission investments are investments that have been made, and have not yet either been fully repaid or written off as a loss. This total reflects the amount committed at the time of investment for investments that have not yet completed. It does not equal the amount outstanding because some of the committed investment amounts have been repaid. However, since total outstanding amounts were unavailable, we use this as a proxy.
[27] The few corporate foundations studied allocate relatively higher percentages of their assets to mission investments, though this figure is somewhat misleading because corporate foundations are often not endowed but are funded periodically by their parent corporation, so the asset denominator for this calculation does not always reflect the total assets utilized by the foundation.
[28] Emerson, Jed. "Where Money Meets Mission: Breaking Down the Firewall Between Foundation Investments and Programming," Stanford Social Innovation Review, Summer 2003.

SOCIAL PURPOSES OF MISSION INVESTMENTS

Foundations have tended to concentrate their mission investments in four issue areas: Economic Development, Education, Housing, and the Environment.



Social Purposes of Mission Investments

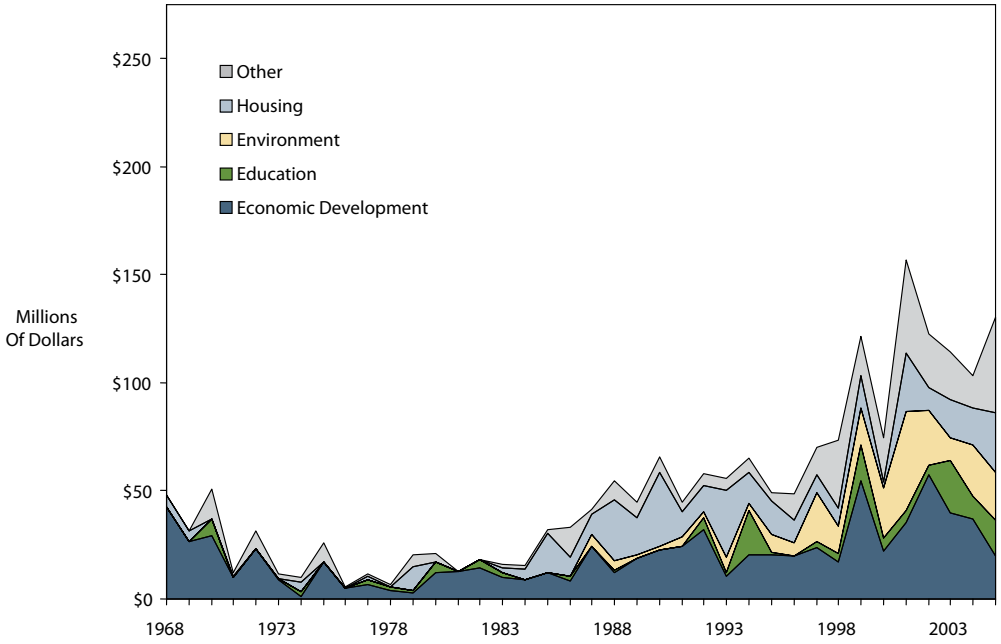
Although assessing the social impact of mission investments was beyond the scope of this study, we did ask foundations if they track the social performance of their investments. Unfortunately, we found that very few foundations require their investees for an accounting of the social benefits achieved. Of those that do, most required only periodic, qualitative assessments of progress. In general, foundations indicated that they would like to do a better job of determining the social impact of their mission investments.

Although we do not have data on social performance of mission investments, we do know the issue areas that foundations are attempting to address. Economic Development has consistently been a major recipient of mission investments, particularly because it is a major focus of the Ford Foundation, which has been active in mission investing for decades. Starting in the early to mid-1980s, Housing and Environment also became major targets of mission investing.

Due to their high levels of investment, the four most active foundations account for major portions of the dollars flowing into each issue area. Eighty percent of all Environment mission investment dollars over the entire time period studied was in PRIs made by the David and Lucile Packard Foundation, 48% of Economic Development funding came Ford Foundation PRIs, and 73% of all Education dollars were invested by the large anonymous foundation. Housing has been a priority for both the John D. and Catherine T. MacArthur Foundation and the Ford Foundation, with PRIs from the two comprising 35% and 27%, respectively, of all funds invested in this category.

Due to their high levels of investment, the four most active foundations account for major portions of the dollars flowing into each issue area.

Dollar Amount of New, Committed Mission Investments per Year by Primary Program Area



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 but large equity investments to education nonprofits are not included in this trend analysis.

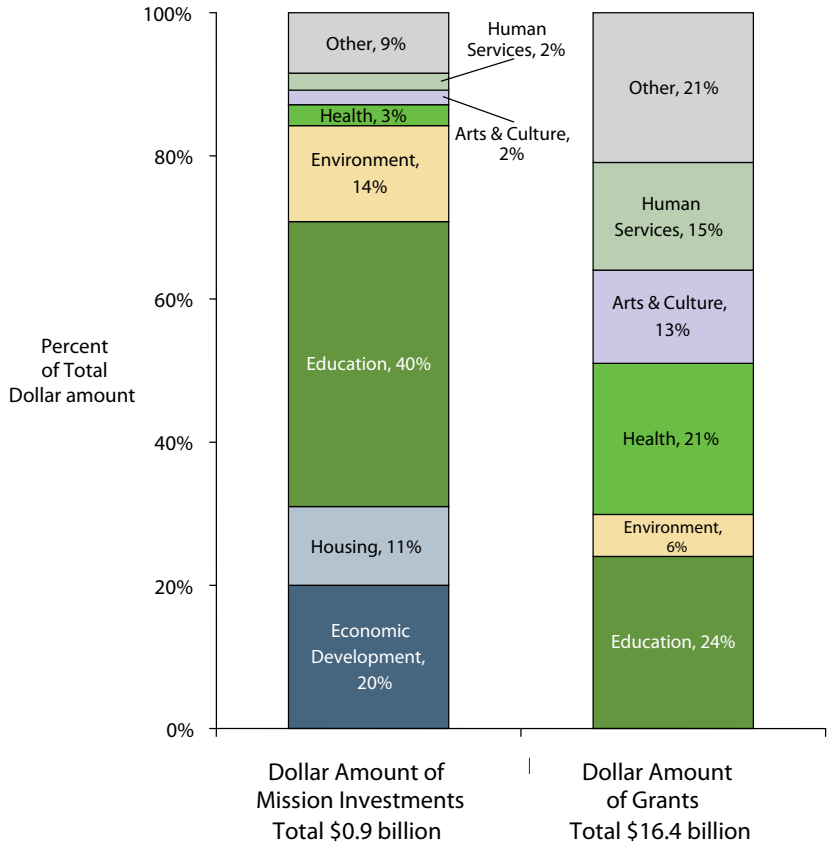
Comparing the distribution of mission investment dollars over the last five years with the distribution of grant dollars in 2005, it is clear that Economic Development has been a greater target of mission investments than of grants. This is not surprising, as there are well-established investment intermediaries specializing in Economic Development and many of the organizations addressing this issue area are for- profit organizations and hence less likely to receive grants.

Issue areas that typically receive major grant funding, such as Arts and Culture, Health, and Human Services, have not yet benefited to the same degree from mission investments. The field would benefit from further study to determine if viable investment vehicles could be used in these areas.

Examples of Foundation Mission Investing

- A foundation makes a recoverable grant to a housing agency to help finance the cost of a site plan application to a zoning and planning commission. If the project is approved and financing is secured, the housing agency repays the grant.
- A foundation invests in a security backed by a pool of loans to low- and moderate-income borrowers to purchase homes across the southern US.
- A foundation provides a credit line to a local land trust to finance periodic purchases of land for preservation.
- A foundation invests in a real estate fund focused on purchasing and developing commercial or mixed-use real estate to spur economic development in a targeted area.

Comparison of Issue Areas Addressed by Mission Investments (2001-2005) Versus Grants (2005)



Note: 2005 grant data for all foundations is from Foundation Center's Foundation Giving Trends (December 2006) based on all grants of $10,000 or more awarded by 1,154 of the largest foundations; grant data does not have Economic Development or Housing categories.

Rigorous Program-related Investing

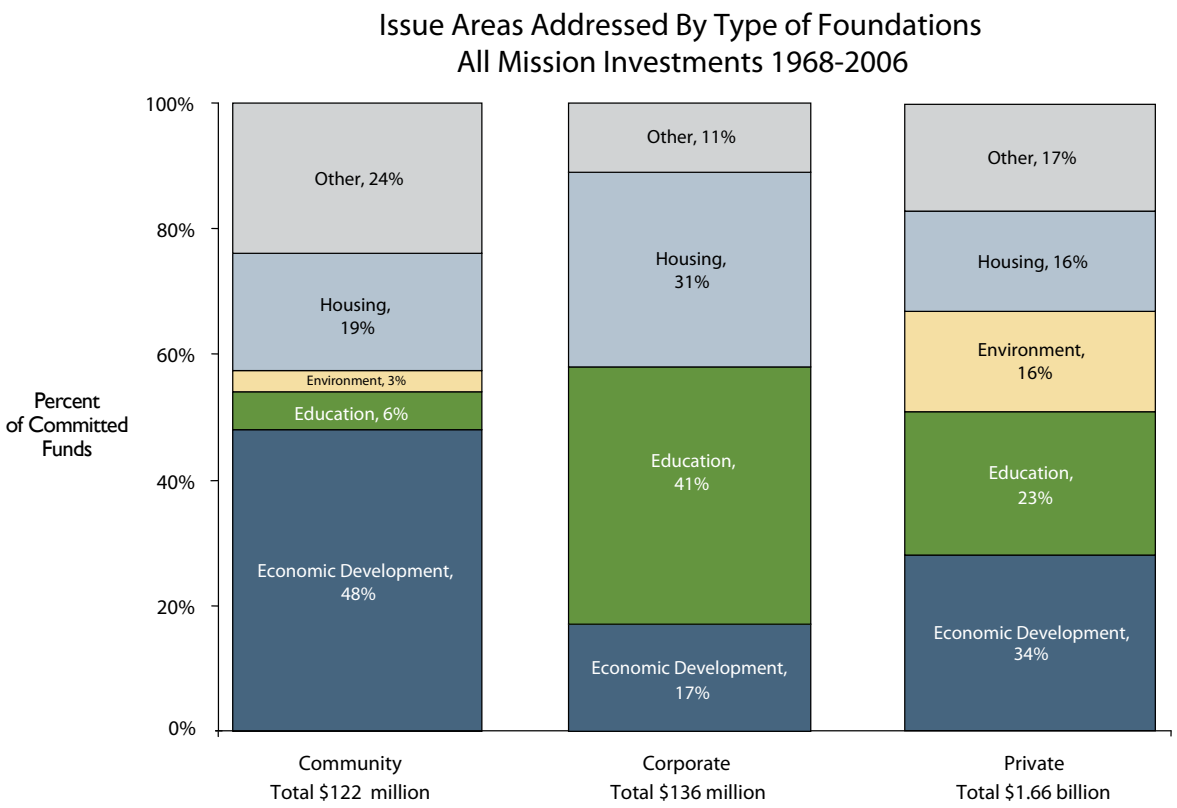
Starting with its first loan in 1980, **the David and Lucile Packard Foundation**, has used a variety of program-related investments in concert with grants to achieve its program goals. These PRIs include loans, deposits, and loan guarantees. To date, the Foundation has concentrated its mission-related investing activity in PRIs although it is considering the potential for market-rate, non-PRI investments.

The Foundation's Board of Trustees has approved targeting up to three percent of its endowment for program-related investments, with up to one percent for loans that could carry some significant risk based on strong programmatic justification. In 2005, the Foundation approved $34 million of program-related investments and over time has made PRIs totaling over $350 million.

In almost all cases, recipients of the Foundation's PRIs are also existing grantees. To align expectations, the Foundation is very clear about its expectations for PRI repayment and requires recipient organizations to acknowledge that it does not intend to simply turn an investment into a grant at a future date.

The Foundation has developed a collaborative, cross-functional structure for managing program-related investments in a way that furthers program goals. The PRI program is managed by Mary Anne Rodgers, Foundation Counsel. She is assisted by another staff member dedicated to PRIs, input from program officers from each of the Foundation's focus areas , and the CFO who provides input on proposed investments.

In 2005, the Foundation approved $34 million of program-related investments and over time has made PRIs totaling over $350 million.

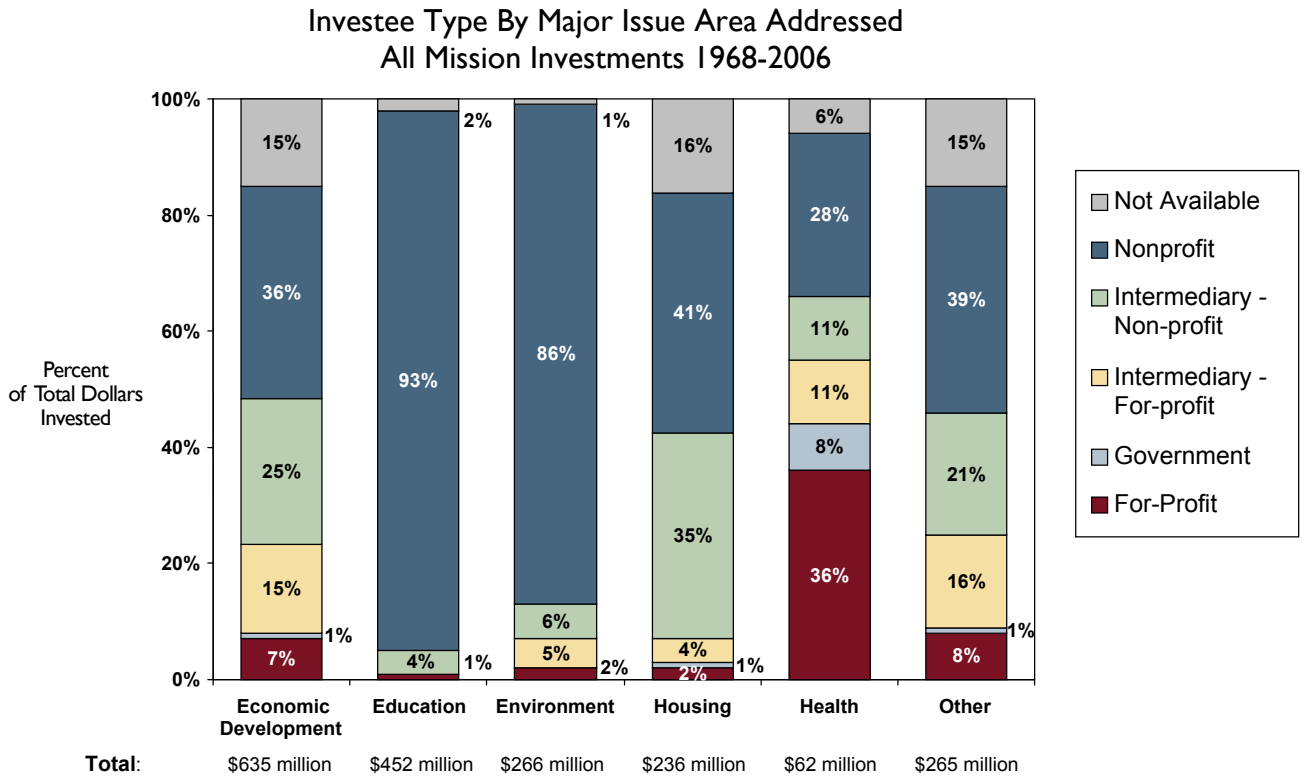


The proportion of mission investments that were made through intermediaries varies significantly among the major issue areas. About a third of mission investments focused on Economic Development and Housing were made through intermediaries, both nonprofit and for-profit.

Due to several large direct private equity investments in biotechnology companies, mission investments in Health include a relatively higher proportion of direct private equity. In addition, a large investment in a state-run health research organization contributed to the larger-than-average proportion of mission investment dollars going to government intermediaries for this issue area.

Examples of Foundation Mission Investing

- A foundation makes a loan to capitalize a microfinance institution that provides micro-loans to women entrepreneurs.
- A foundation makes a deposit in a community development bank at a below-market rate in order to capitalize a loan fund administered by the bank that focuses on redevelopment of the city's central business district.
- A foundation guarantees a loan from a bank to a nonprofit for purchasing a building, enabling the nonprofit to secure a lower interest rate.

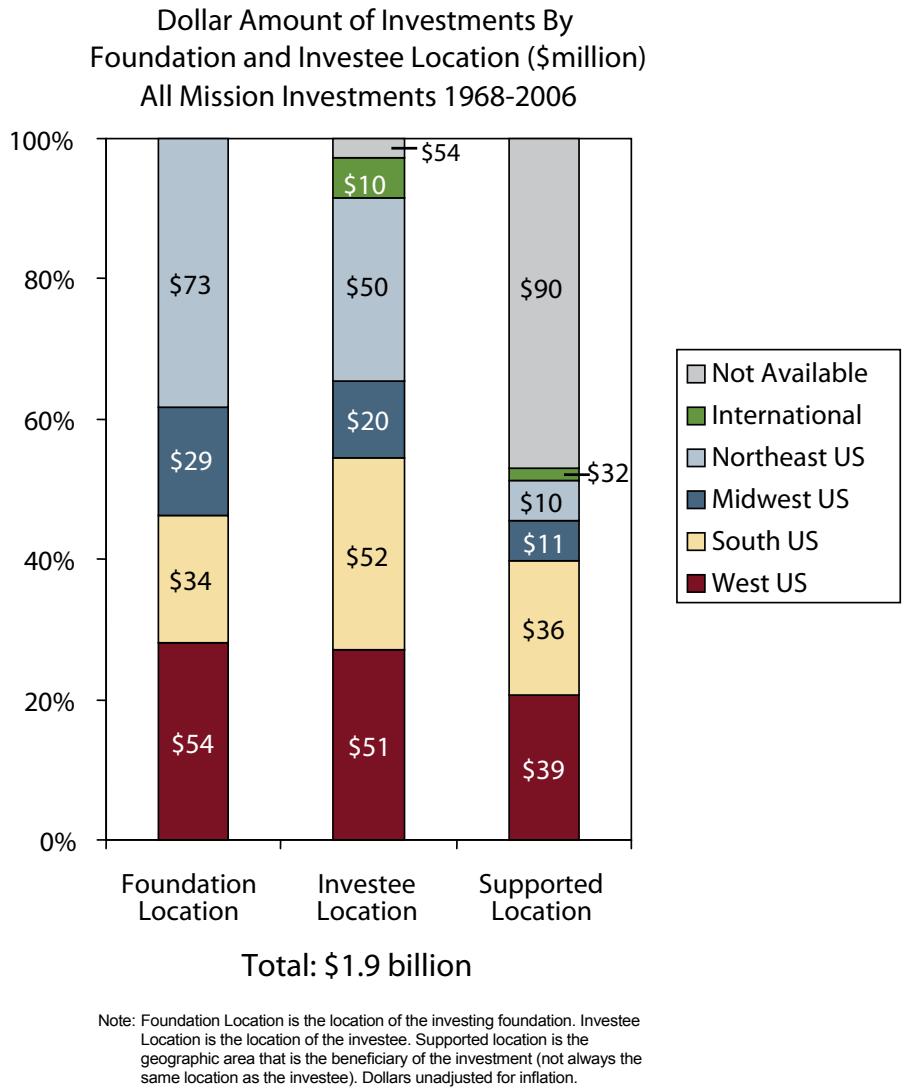


Note: Investee type or primary program area was not available for $190M of investments so they are not included in this analysis. Dollars unadjusted for inflation.

More than 95% of all foundation mission investments were invested in US-based investees, the majority of which addressed US issues. Although their grantmaking also tends to be US-centric, US foundations do allocate a relatively greater portion of their grant dollars (18%) to international purposes.[29]

Not only are most foundations' mission investments focused on US issues, but they tend to stay close to home. We collected data on three locations for each investment: the foundation's location, the investee's location and the supported location (which may or may not be the same as the investee's location). There is an overall trend toward foundations investing in investees located in their own regions and, based on available data, in support of their own regions as well. This is not surprising given the place-based focus of community foundations and the local missions of many private foundations. However, some foundations in the Midwest did note that it is difficult to find sufficient investment opportunities in their areas. As one put it, "There's more going on either coast than in the Midwest. There just aren't many good opportunities here. We don't see many equity deals."

More than 95% of all foundation mission investments were invested in US-based investees, the majority of which addressed US issues.

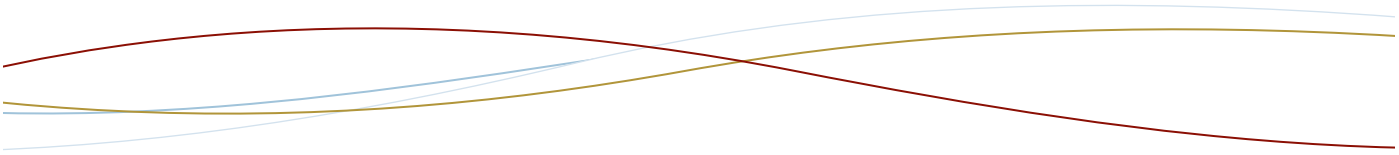


Note: Foundation Location is the location of the investing foundation. Investee Location is the location of the investee. Supported location is the geographic area that is the beneficiary of the investment (not always the same location as the investee). Dollars unadjusted for inflation.

[29] International Grantmaking Update, Foundation Center, October 2006.

MISSION INVESTMENT MANAGEMENT

oth program and finance staff perspectives are vital to manage mission investments.



Mission Investment Management

Foundations were, of course, organized to manage grantmaking, and most use outside advisors to manage their endowment investment portfolios. Since most foundations engage in mission investments only sporadically, or dedicate only a small fraction of their assets to the investments, very few have developed the unique processes and controls to manage mission investments on a consistent and reliable basis.

Staff Oversight

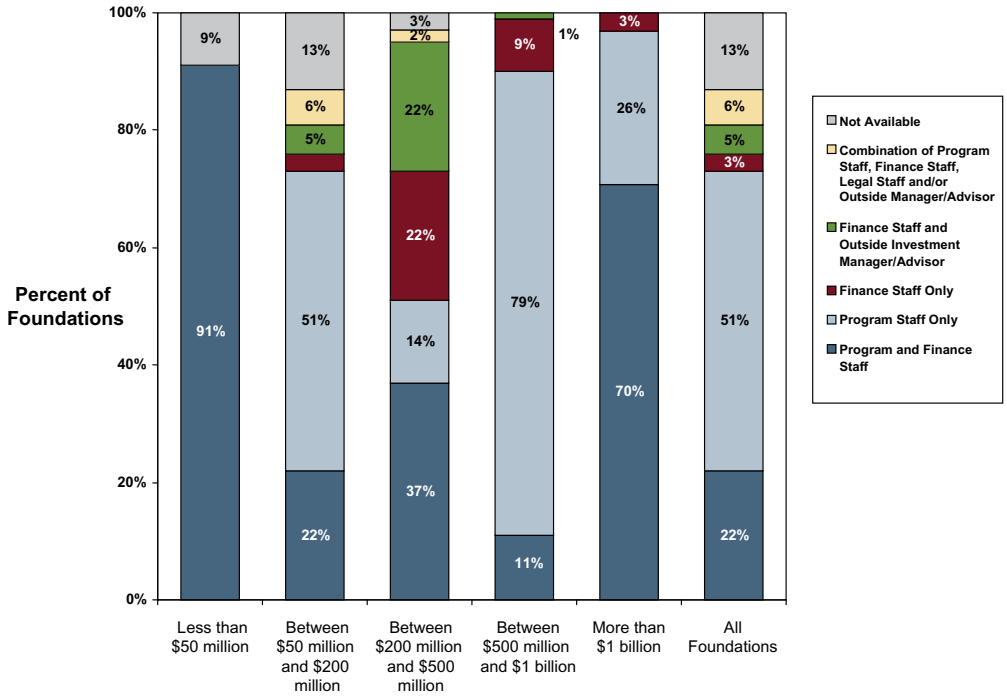
From our conversations with foundations, it is clear that both program and finance staff must participate in managing mission investments. These two departments' perspectives are vital for sourcing, due diligence, oversight, collections, and reporting.

In about half of the foundations we studied, mission investments are managed primarily by program officers. While this is understandable – many of the investments are made, after all, with program funds – program staff often lack the financial expertise to conduct sufficient due diligence and to effectively evaluate and manage investments. Although program staff typically rely on the foundation's finance personnel to process and track mission investments, they aren't as likely to include their finance colleagues in due diligence and performance evaluation processes. Interestingly, it seems that the lack of communication and coordination is less pronounced in smaller foundations. Said one interviewee: "We all wear many hats and so we talk all the time."

Only about a quarter of foundations have their program and finance teams work together to manage their mission investments in a coordinated manner.

Only about a quarter of foundations have their program and finance teams work together to manage their mission investments in a coordinated manner, and most of these arrangements still seem to give greater emphasis to program staff's involvement. "Management of these investments is shared but it's seen as a program function," said one community foundation. Some foundations have created a committee of program and finance staff to focus on mission investments: "We went ahead and created a separate committee to handle the PRI side of things. The grant staff and investment committee both said it's not their thing so we made it separate," explained a private foundation.

Mission Investment Management Approach By Foundation Size



Some foundations noted that they have sought advice on mission investing from their traditional investment advisors though few seem to have found them to be as helpful as hoped. Most of these conventional advisors are not familiar with mission investing other than SRI funds.

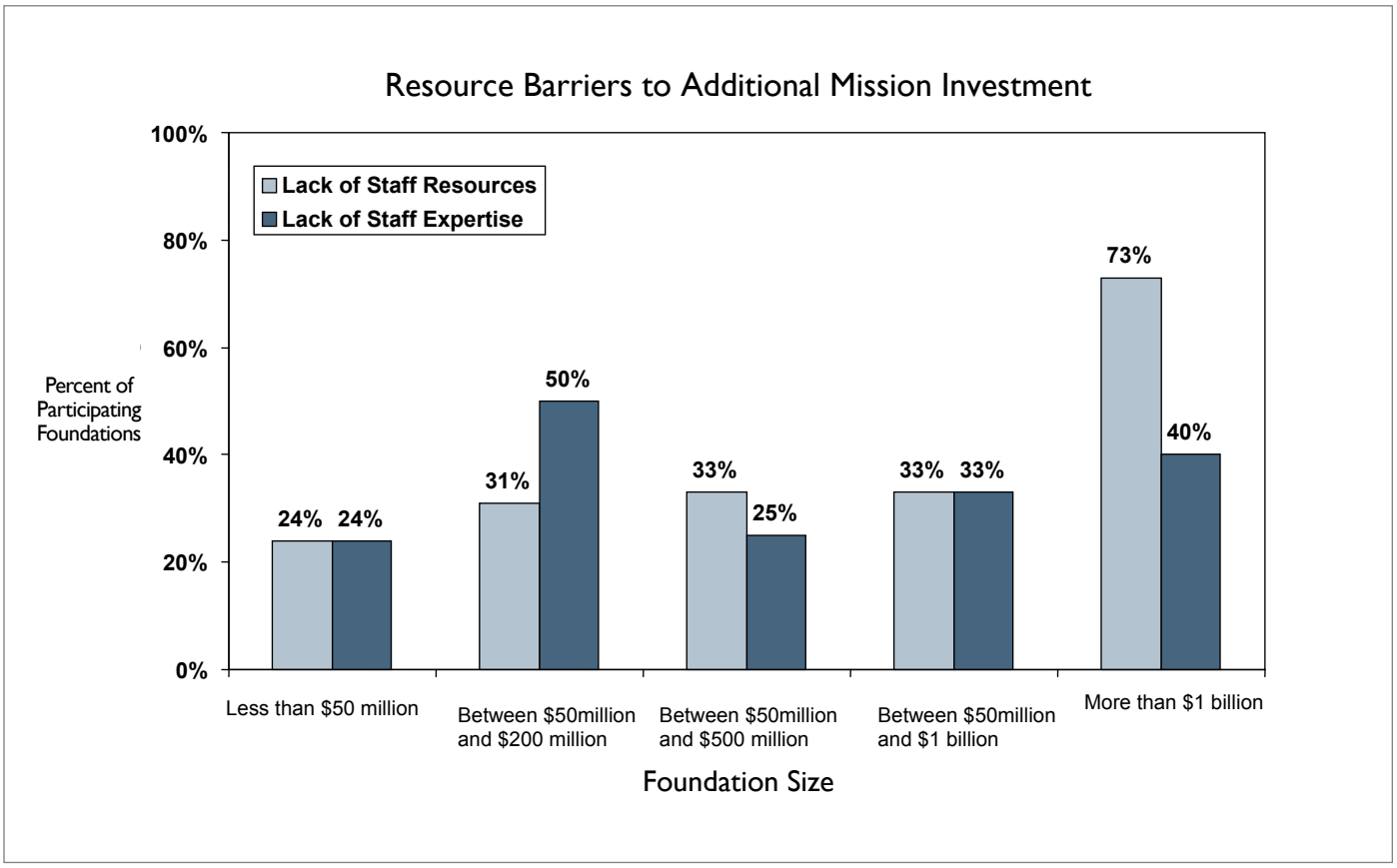
Approximately 11% of foundations use specialized consultants to assist with deal structure, sourcing, or due diligence.

Approximately 11% of foundations use specialized consultants to assist with strategy deal structure, sourcing, or due diligence. "We work with a couple of consultants – we bring them in on an as needed basis when we need specific expertise," said one private foundation. Some foundations reported that they have had difficulty finding consultants to help with market-rate investments. "The big barrier on the market-rate [mission investment] side is the lack of consultants who can help us bridge the financial investment with the mission investment goals within a pretty aggressive investment policy," reported a private foundation.

Regardless of which group manages mission investments, nearly 40% of foundations indicated that a shortage of staff resources or time is a barrier to making more of these investments. Making and managing mission investments takes time, sometimes more so than grants, especially as a foundation learns how to use these tools. Many of the larger foundations active in mission investing have dedicated staff for these activities, but with their larger pools of investments, they were even more likely to note a lack of staff resources than their smaller peers.

Similarly, nearly 40% of all foundations said that an absence of staff expertise in mission investing is constraining their activity. Particularly lacking are general financial skills, especially among program officers, and knowledge of mission investing approaches and theory. Foundations in the $50 to $200 million range, which have seen the greatest recent growth in mission investing, noted this barrier more often than other foundations.

Foundations that make infrequent mission investments find the lack of staff resources and expertise to be especially challenging. As a CFO of one private foundation noted, "We make these investments so infrequently that it's tough. In order to do them efficiently, you either need to have outside advisors or internal expertise. We just didn't have it." For these foundations, making direct investments can be so daunting that investing through intermediaries is often a better option.



Funding Source

Foundations fund their mission investments out of three general "pools" of assets:

- ***Program dollars:*** Foundation assets that are annually allocated to philanthropic activities. (For community foundations, certain allocations of program dollars may be directed by donors rather than determined by the foundation itself.)
- ***Endowment dollars:*** Foundation assets that are not allocated to program dollars or operations. A foundation usually focuses on expanding its endowment through investments in order to fund ongoing grantmaking.
- ***Segregated endowment dollars:*** A subset of endowment assets that some foundations earmark for making mission investments. Typically, the foundation reports the investment returns of this pool separately from those of the rest of the endowment.

Many foundations are adamant about focusing purely on financial returns in their endowment investment decisions. "I won't do social investing out of the endowment. I just make money so they can give it away," said one foundation CFO. As a result, over 43% of the foundations studied fund their mission investments only with program dollars.

About half of the foundations that provided data for this study have used endowment funds for at least one mission investment.

However, our interviews revealed that a growing number of foundations are at least considering the use of their endowment funds for mission investments, and about half of the foundations that provided data for this study have used non-segregated endowment funds for at least one mission investment. Among foundations that are open to using endowment funds for mission investing, there is still a focus on financial return, however, so they are most receptive to market-rate mission investments.

Most community foundation mission investments – 79% – were funded by foundation-directed dollars. As one community foundation put it, "Given our role managing our own endowment funds, donor funds and other nonprofits' funds, we feel that capital for these [mission-related] investments has to come from our own sources. Our obligation to our donors and the nonprofits is to maximize their return on investment." Of the mission investments that used donor-advised resources, most were brought to the attention of the donors by the foundation based on the donor's areas of interest.

Investing with Segregated Endowment Funds

Though active in mission investing for less than a decade, the **Annie E. Casey Foundation** has recently made it an organizational priority, setting aside $100 million in endowment funds (about 3% of total assets) for mission investments.

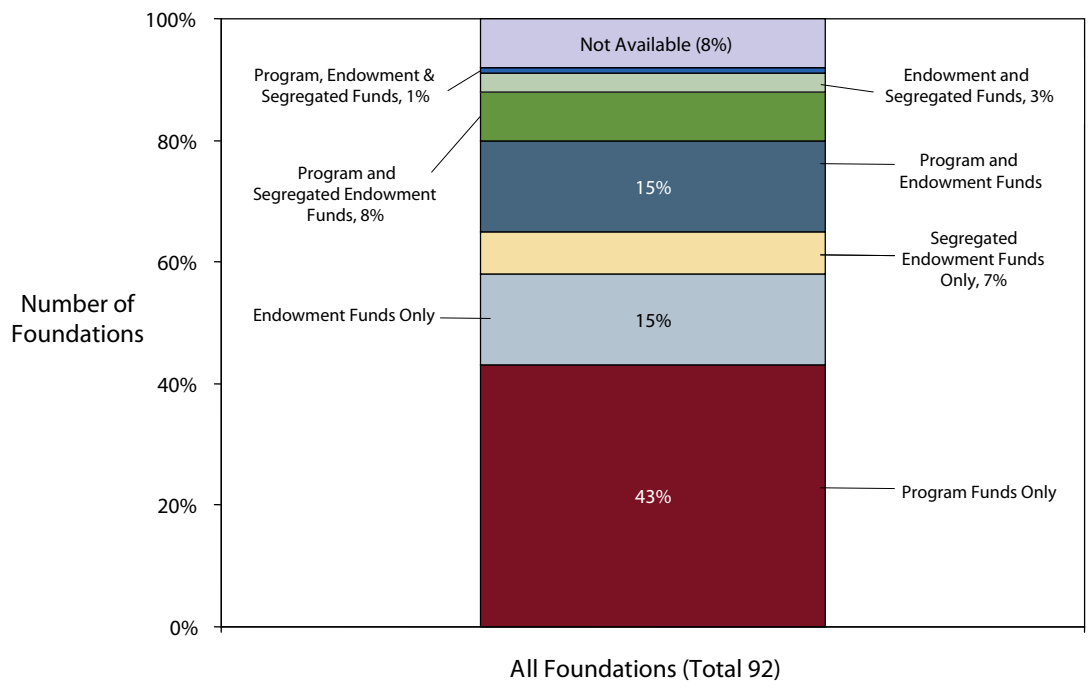
Starting in 1998 with insured deposits, the foundation has made a variety of debt and equity mission investments including loan guarantees, senior and subordinated loan funds, private equity funds, and venture capital funds. As of mid-2006, the foundation had committed nearly $40 million to mission investments, with about $11 million outstanding.

Christa Velasquez, Director of Social Investments, oversees the process of sourcing, assessing, and managing these investments, assisted by another mission investment staff member and Burt Sonenstein, Chief Financial Officer. A mission investment committee made up of about 15 staff members from throughout the foundation provides program and organizational guidance. When necessary, the foundation engages consultants, both individual practitioners and firms, to help with underwriting, portfolio management, and performance reporting.

"I would encourage any foundation to utilize a portion of their endowment for mission related investing. When combined with the program work, mission related investing provides greater opportunities for achieving impact in the foundation's mission."
– Christa Velasquez

To approach mission investing strategically, it is helpful to determine in advance what portion of the foundation's assets will be allocated to mission investments. About a quarter of the foundations we interviewed have a set budget for their mission investments, typically between 1% and 5% of their total assets. Several have allocated larger amounts, including the F.B. Heron Foundation, with 24%, and another private foundation that plans "to be fully invested in investments that are tied to our mission in five years." However, most foundations have not yet set specific targets and instead act opportunistically. Reported one private foundation: "We haven't set aside funds for this kind of thing, we just jump on opportunities that come to us from our grantees or community."

To approach mission investing strategically, it is helpful to determine in advance what portion of a foundation's assets will be allocated to mission investments.



Note: 7 foundations did not indicate funding source so they are not included in this analysis.

Allocating Assets For Mission Investing

The Vermont Community Foundation, (VCF) has an investment policy that allocates 5% of its pooled assets for investments in companies, agencies, or intermediaries that support and promote healthy and vital Vermont communities, as outlined in VCF's strategic goals.

As a community foundation serving the entire state, VCF focuses on investments that result in jobs, economic development, and financial services for low-income Vermonters.

Currently, VCF's mission investments are in loans and insured deposits at Vermont CDFIs, a fixed income fund based on loans to low-income families, and venture capital funds that target Vermont companies. As of the end of 2007, these investments are anticipated to total about $6.6 million.

VCF manages these mission investments in close cooperation with its "traditional" investment advisor who provides advice and oversight. In addition, VCF has also contracted with the Calvert Foundation to provide due diligence for potential CDFI investments and reporting on the foundation's current CDFI investments.

Risk Assessment and Management

Few foundations have a structured process for measuring and rating the risk of potential and current mission investments, but most do consider financial, mission-related, and other risks when assessing an opportunity.

We found that the rigor with which foundations assess the financial risk of potential mission investments varies by type of expected return and by foundation perceptions of mission investments. If the investment is a market-rate mission investment and endowment funds are to be used, foundations analyze risks thoroughly. If the mission investment is to be funded by program dollars, however, a spectrum of approaches are taken. About a quarter of foundations appear to diligently assess financial risk. Nearly all of these foundations noted that they're willing to take on significant levels of risk if the potential social impact is great, but that they want to be fully informed in making the decision. On the opposite end of the spectrum, another quarter of foundations indicated that they spend little time assessing financial risk because they use program dollars and consider the mission investments to be quasi-grants. They voiced little concern with preserving capital. One said, "We consider the financial risks but if we don't get paid back, it's OK, we'll reclassify it as a grant."

One way that foundations minimize the financial risks of their investments is to invest in their current grantees. Noted a private foundation: "Not only do we already know if they're trustworthy or not, but there is unspoken leverage we have with our current grantees that take loans from us. They want future grants and they know that failing to repay the loan could be bad for public relations and potentially harm their chances of future grant funding." Over 40% of mission investments are made to foundations' former or current grantees. In addition, a few foundations actively share their due diligence findings with peers that address similar geographies or issues, minimizing duplicated effort and strengthening risk analysis.

Foundations have many options for structuring mission investments to limit risk:

- Phasing the payout of funds so that if the investment becomes jeopardized the foundation only loses what it has invested so far.
- Co-investing with other organizations (including foundations, pension funds, educational endowments) or investing through intermediaries to spread the risk.
- Requiring collateral and specifying recourses in case of default. Even if an investment is fully collateralized, however, the reputational repercussions of seizing the collateral sometimes deter foundations from acting. "Even though we took a lien on the building, we would not have foreclosed on them. We would not have pursued it if they could not pay us back. It would have been negative for us publicly and would have damaged important community relationships," said one private foundation.
- Diversifying a mission investment portfolio across asset classes, investee types, and durations.
- Working closely with the investee to identify needs related to fulfilling the investment. ("Our staff helps some of our investees do their books to make sure it's done well. One way of mitigating risk is to be up close and personal with these organizations," said a private foundation. Another foundation makes sure it has a seat on major investees' boards.)
- Placing limits on the percentage of ownership held in an equity investment.
- Setting aside a loss reserve.
- Providing a grant to the investee to help it build capacity or strengthen its balance sheet.

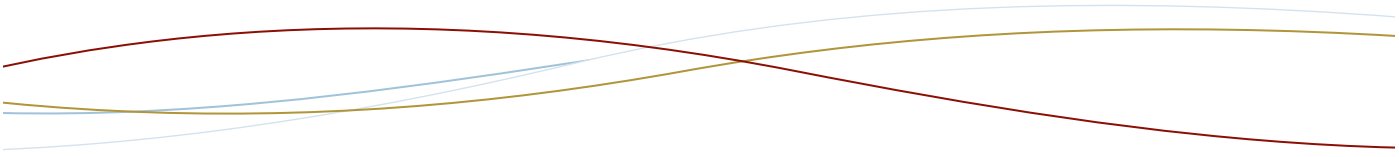
Foundations consider two primary social risks. The first is very familiar to grantmakers: the risk that the recipient will fail to achieve the desired social benefits. Foundations must assess whether they think (a) the investee is capable of achieving the promised social change and (b) the mission investment is the right vehicle for helping the organization to achieve that change. The second social risk is the possibility of burdening the investee (particularly a nonprofit organization) with a liability that it can't repay. Such a liability may distract the organization from its work, harm its credibility with other funders, and damage its credit rating.

Finally, some foundations consider two other types of risk: reputational and regulatory. Reputational risk comes in two forms. First, negative public perceptions could result from forcing a defaulted investee to repay or seizing the agreed collateral. Second, the public may perceive a foundation to be greedy if it makes a significant number of mission investments. "We have bent over backwards in our housing investment program to make sure that everything we've done is more than fair," said a community foundation. "We didn't want people to think we were trying to take advantage of poor people." The general public may be familiar with philanthropic grants, but it is far less aware of mission investments. As a result, people may not understand why a foundation might expect to be repaid. One private foundation noted, "The more place-based you are, the more you have to take into account reputational risk."

Regulatory risk was mentioned by a few foundations. They worry about making investments that the IRS perceives as not meeting PRI guidelines and therefore not qualifying to be counted in the annual payout. In addition, foundation trustees worry about violating fiduciary duty regulations regarding investments. In both cases, a lack of clear guidelines leads some foundations to be especially conservative.

MISSION INVESTING – BUILDING ON THE MOMENTUM

The current momentum suggests that now is the right time for the practice of mission investing to mature and flourish as a vital arm of philanthropy.



Mission Investing – Building on the Momentum

Throughout our research, we had the pleasure of talking with foundations across the country that are making innovative, high-impact mission investments. We also heard, however, about the challenges foundations face in utilizing mission investments more widely and more successfully.

For mission investing to build on its current momentum and grow significantly – in number of participating foundations, dollars invested, and social impact achieved – three key changes are required:

1. Greater understanding of and proficiency in mission investing among foundation staff and boards
2. A more robust marketplace for mission investments, including direct investment opportunities, mission investment intermediaries, and suitably qualified consultants
3. Improved mission investment performance measurement, record keeping, and information sharing

1. Greater understanding of and proficiency in mission investing among foundation staff and boards

Although mission investing has been widely discussed in recent years, most foundations know very little about the variety of investments and their benefits. Even the foundations that already engage in PRIs and other mission investments do so in very limited ways. "We've only made loans… I don't even know what else is out there," one community foundation told us.

Many foundations have a staff member who is knowledgeable about mission investing. But a lack of awareness on the part of foundation trustees, finance staff, auditors, and investment advisors often holds foundations back from more fully aligning their investments with their missions. An understanding at the board level appears to be an especially important factor in the decision to pursue mission investing. As one private foundation noted, "It isn't really lack of board support, it's a lack of board education."

In particular, boards are often held back by concerns about fiduciary duty and a misunderstanding of the IRS requirements for PRIs. Although it is beyond the scope of this report, we briefly consider these two points below.

Fiduciary duty. Interpretations of the fiduciary duty of institutional trustees have evolved considerably in the last 50 years. The current standard of "good business sense" accepts the idea that reasonable levels of risk can be incurred as long as they are justified by the expected returns and counter-balanced by other investments in the overall portfolio. In recent years, foundations have taken full advantage of this more flexible standard by diversifying into private equity, hedge funds, foreign currencies, and other investment vehicles that would have been considered imprudent just a few decades ago. Much less attention has been focused on the parallel requirement that boards consider *the purpose of the institution* in managing investments. In this regard, the public purpose and donor intent of charitable foundations distinguish them from other nonprofit institutions such as university endowments or pension funds. If an investment furthers the donor's intent and provides benefits to the public, that may be reason enough to accept a lower return or greater risk — especially if the entire portfolio is not placed at undue risk.[30] Overcoming this perceived obstacle, however, requires further legal research, better education of boards, and further clarification of the Uniform Management of Institutional Funds Act as it applies the special case of charitable foundations and mission investments.

PRI guidelines. Private foundation boards sometimes assume that all mission investments must be PRIs under the Internal Revenue Code, and that only zero interest or below market-rate loans qualify for this status. Many foundations have therefore shied away from market-rate or equity investments. Mission investments need not be limited to PRIs, however, and the IRS neither limits PRIs to debt instruments nor disqualifies them merely because they achieve market-rate returns. The test is that the *primary purpose* is to accomplish one or more of the foundation's exempt purposes and that the production of income or appreciation is not a *significant purpose*. There has been relatively little interpretation of these regulations, however, and without clearer guidance, foundations and their counsel have tended to adopt a very conservative stance. "As much as you tell the board there's a strong purpose, they get nervous when auditors come in talking about write-downs. They spend a lot of time looking at PRIs since valuing them is harder. It worries the board and staff," said one community foundation.

Beyond better board education, there is a clear need for greater proficiency on the part of foundation staff in managing mission investment portfolios. Even the foundations that are convinced of the value of mission investing struggle with implementation and would benefit from more training and assistance on how to:

- incorporate mission investments into their strategic plans,
- find and conduct due diligence on potential deals,
- structure mission investment terms,
- manage and track mission investments, and
- evaluate performance.

[30] See the Uniform Management of Institutional Funds Act. See also Kramer, Mark R., "Foundation Trustees Need a New Investment Approach," The Chronicle of Philanthropy, March 23, 2006

The lack of expertise can be traced to the fact that most foundations have not yet made mission investing a strategic priority. As one community foundation admitted, "So far, we've been opportunistic and rather loose. We're not really making strategic decisions about how to embark in this area." As a result, foundations have rarely hired specialized staff with both investment finance and nonprofit sector experience or even established formal internal processes for program and finance staff to work together to select, manage, andevaluate investments.

Just as grants can be ineffective without focus, rigor, and strategy driving them, mission investments will not achieve the social impact or financial return that foundations desire unless they receive targeted, strategic attention and are implemented with the appropriate expertise.

2. A more robust marketplace for mission investments, including direct investment opportunities, mission investment intermediaries, and suitably qualified consultants

We often heard foundations voice frustration about the lack of suitable mission investment opportunities available. The issue seems to encompass three primary challenges:

Difficulty finding potential deals

There is no centralized service that provides deal "matching" between foundations and potential investees. As a result, foundations must hunt down potential mission investments by talking with their grantees and other foundations. "It's not as if you can go to a database that has a listing of all mission investments, market-rate and otherwise, and look for something related to your mission. We have to find and bring ideas for investments and work with our grantees to build opportunities," complained one private foundation. Growing the field will require some sort of central "marketplace" or referral mechanism for mission investment opportunities.

Several organizations are starting to meet this need, including:

- ***The PRI Makers Network (primakers.net):*** Network members proactively share deal information with one another online and at conferences.
- ***xigi.net:*** Currently in beta testing, this web site offers a blog for dialogue among social investors, investees, and intermediaries. It aims to provide a deal database of entities and offerings that show deal sizing, terms, and other critical data such as relationships between mission investment actors.
- ***The Community Investing Database (communityinvestingcenterdb.org):*** Provided by the Community Investing Center, a collaboration between the Social Investment Forum Foundation and Co-op America, this database enables users to search for mission investments offered by community development financial institutions. The database is searchable by key factors such as issue area addressed, asset class, geographic region served, and intermediary type.
- ***The MIX Market (mixmarket.org):*** This web site provides profile and performance data on microfinance funds and institutions and allows users to search for funds by geography and fund type.

Insufficient mission investment intermediaries

Direct mission investing by foundations is time-consuming and resource-intensive, and as noted earlier it requires a specialized skill set that few foundations currently have. Most direct mission investments are relatively small, with customized terms and high transaction costs. It is unlikely that foundations will participate in mission investing in any widespread way until more efficient options are developed. "If it is difficult to do, foundations don't do it. If you make it easy for foundations, they'll do it," said one private foundation.

Investing through intermediaries enables foundations to engage in mission investments as easily as traditional investments. Intermediaries can develop a strong deal flow, build expertise, and gain economies of scale that individual foundations cannot. Noted a small private foundation: "Having more knowledge will not help until we figure out some way to increase the capacity of smaller foundations to handle mission investment."

If intermediaries are to work in concert with foundations' programmatic goals, they will need to organize their funds around specific issue areas and geographies. Said one private foundation: "It's great that there are lots of [intermediaries] to invest my money through in affordable housing but we're an environmental foundation focused in one region of the country. I need something that is relevant to me."

Although many intermediaries already exist, they are often not well known. Many of the foundations we interviewed were unfamiliar with the wide range of community development banks, credit unions, loan funds, and equity funds. Assessing the full range of mission investment opportunities through intermediaries and identifying gaps that might be filled was outside the scope of this report, but it is an important issue for further study.

Few qualified consultants and advisors

Foundations' traditional investment advisors are rarely familiar with mission investing or social investing beyond screened funds, and relatively few consultants combine the social and financial qualifications necessary to advise foundations on how to source, structure, and manage mission investments. "The field needs [mission] investment advisors available. Who is doing this role for PRIs and other things?" said a private foundation. Although a number of consultants do assist foundations with their mission investing, there appears to be a need for more advisors, particularly ones without product agendas, to help foundations plan their mission investment strategies and facilitate individual transactions. Commented a private foundation: "They should not be pushing their own products; there should be no self-interest issues."

3. Improved mission investment performance measurement, record keeping, and information sharing

To become more informed about mission investing, foundations need robust data on the range of potential investments available and the financial returns that they can achieve. Although this report helps to establish a baseline of mission investment activity and performance, a process for ongoing data collection, analysis, and benchmarking will be necessary to keep foundations up to date.

Tracking the social impact of mission investments will also be essential to further development of the field. Demonstrating the value of mission investments as a philanthropic tool will require evidence of the ways that mission investments have achieved social and environmental benefits equivalent to or greater than those achieved by traditional grantmaking.

When only a handful of large foundations engaged in mission investing, they could share information informally with each other or through the few specialized consultants. The field has outgrown this knowledge transfer approach, however, and now requires more formal and organized methods of sharing information. Fortunately, there is now an association for grantmakers who are interested in PRIs and other mission investments called the PRI Makers Network. This membership association is starting to convene foundations for knowledge sharing and is offering regular classes. The PRI Makers Network will also soon provide an additional learning tool for its members: a searchable database of mission investment deals, the data for which came from this FSG study.

Although the PRI Makers Network provides a valuable forum for training and best-practice sharing, nearly half of the foundations we interviewed are not yet members and few of these were even aware of the organization. Given what we heard from foundations, there is clearly room for increased knowledge sharing, so hopefully more of these organizations will find a way to share their experiences with one another, whether through the PRI Makers Network or not. Beyond conferences and training sessions, foundations also need comprehensive materials on how to source, do due diligence on, manage, track, and evaluate the full spectrum of mission investments. These materials must to be developed and made widely available in order to arm foundations with the tools and expertise necessary to become better mission-related investors.

In collecting the documents foundations use to track their investments, we learned a great deal about the varied levels of sophistication with which foundations document their mission investments. A few rigorously track data on each investment, but the majority have lax tracking and reporting. This shortcoming has serious repercussions. If foundations do not track and report the performance of their mission investments, they will not know whether their investments have been successful and they will risk repeating mistakes with additional funds. In addition, if foundations don't track and transparently report their mission investments' performance, the foundation sector will remain unable to aggregate mission investment performance data, both financial and social. An aggregate view would not only be invaluable in helping foundations learn from their peers but would also be a useful tool for identifying gaps that can be addressed at a sector level, such as a need for an investment intermediary in a certain issue area.

To fill this gap, foundations must become more diligent about tracking and reporting their PRI and mission investment portfolios. Four of the foundations we studied have sophisticated tracking databases, some with links to their grantmaking systems so that they can review all their program activities in one place. Many foundations may not need such sophisticated databases, although it would be extremely helpful to develop a common template that would enable mission investment data to be tracked consistently. Having such a template would make it easy for foundations to set up their own recordkeeping system, and enable field-wide data to be aggregated and used for periodic benchmarking and analysis. Our research suggests that better access to such information is a critical element in advancing the use of mission investments.

Conclusion

US foundations' participation in mission investing has picked up speed in the past decade. Although investing is still heavily weighted toward below market-rate loans, interest in other asset classes and in market-rate mission investments is increasing. Through our conversations with 92 foundations, our Advisory Board members, and other key sector experts, we sense a growing momentum for mission investing. We are hopeful that more foundations and their boards will become knowledgeable about mission investments and have informed conversations about the potential for using these investments as another philanthropic tool along with grants.

A private foundation that is currently very active in mission investing told us that building an mission investment strategy "has been an 11 or 12 year process for us. We learned about it and talked about it for ages and ended up putting together a draft of guiding principles for this before there were even good investment opportunities. I remember when the board was saying that there should be positively screened funds, not just negative. How far everything has come since then. Things have caught up." This foundation is right -- or at least half-right. The universe of mission investments is broader than ever, increasing numbers of foundations are making mission investments and sharing their knowledge with one another, and there is growing momentum for including mission investments in strategic approaches. But if mission investing is to further mature, foundations must become more informed, skilled, and rigorous in sourcing, assessing, and managing their mission investments. In addition, critical infrastructure changes must occur: increased mission investment options through intermediaries, clearer regulations, aggregate performance benchmarking, and greater transparency of deal activity and results.

Given recent public attention to how foundation assets are invested and given the unique capabilities of mission investments to help foundations reach their ever more challenging missions, now is the right time for foundations to consider mission investing and work together to help the practice mature and flourish as a vital arm of philanthropy.

APPENDIX

- Bibliography
- Project Methodology
- Participating Foundations
- Asset Classes Defined
- Mission Investing Glossary
- Sources for Additional Information

Bibliography

Annie E Casey Foundation. "Glossary of Terms." *PRI Makers Network*. primakers.net.

Carden, Steven D. and Darragh, Olive; "A Halo For Angel Investors", The McKinsey Quarterly, 2004 Number 1

The CDFI Data Project, "Community Development Financial Institutions: Providing Capital, Building Communities, Creating Impact." 2004

The Community Investing Center. www.communityinvest.org

Council on Foundations. "Glossary of Financial Terms." cof.org

Council on Foundations. "Glossary of Philanthropic Terms." cof.org

Emerson, Jed. "Where Money Meets Mission: Breaking Down the Firewall Between Foundation Investments and Programming", *Stanford Social Innovation Review,* Summer 2003

Emerson, Jed, Bonini, Sheila. "The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation", *blendedvalue.org,* October, 2003.

Emerson, Jed, Spitzer, Joshua, Mulhair, Gary "Blended Value Investing: Capital Opportunities for Social and Environmental Impact", *World Economic Forum,* March, 2006.

Emerson, Jed. Freundlich, Timothy, Berenbach, Shari. "The Investor's Toolkit: Generating Multiple Returns Through a Unified Investment Strategy" *blendedvalue.org*, Summer, 2004.

Ford Foundation. "Investing for Social Gain: Reflections on Two Decades of Program-Related Investments" 1991

Huang, Judy, Buchanan, Phil, and Buteau, Ellie. "In Search of Impact: Practices and Perceptions in Foundations' Provision of Program and Operating Grants to Nonprofits." *The Center for Effective Philanthropy*. 2006

Internal Revenue Service, www.irs.gov.

The Foundation Center. "FC Stats." 2004

The Foundation Center. "Foundation Giving Trends." December 2006

The Foundation Center. "International Grantmaking Update." October 2006

The Foundation Center. "The PRI Directory." Second Edition, 2003.

Kramer, Mark R. "Foundation Trustees Need a New Investment Approach." The Chronicle of Philanthropy, March 23, 2006.

Kurtz, Lloyd, "Answers to Four Questions", *The Journal of Investing*, Fall 2005

Lehman Brothers Aggregate Bond Index, *Lehman Brothers,* www.lehman.com

MacKerron, Conrad, Bauer, Doug. "Unlocking the Power of the Proxy." *Rockefeller Philanthropy Advisors, As You Sow Foundation*, 2004.

Ragin, Luther. "New Frontiers in Mission Related Investing." *The F.B. Heron Foundation*, 2004

Van de Velde, Vermeir, Corten; "Sustainable and Responsible Performance", *The Journal of Investing,* Fall 2005

Project Methodology

To develop a comprehensive understanding of mission investing practices at US foundations, FSG spent nearly six months collecting data directly from the foundations themselves.

Participant Selection

At the start, we asked more than 300 private, community, and corporate foundations to participate in the study based on one or more criteria:

- Membership in the PRI Makers Network, an association of grantmakers that engage in PRIs and other mission investments;
- Inclusion in the Foundation Center's PRI Directory, a listing of US foundations that make PRIs; and/or
- Recommendation by our Advisory Board or a participating foundation.

Of this target group, 92 foundations agreed to participate: 64 private, 24 community, and 4 corporate. The number of corporate foundations is low because some declined to participate and several others fund their investments out of the corporation instead of the foundation (we focused this study purely on investments made by foundations).

FSG Social Impact Advisors interviewed each of the 92 foundations, investigating their mission investing programs and approaches, their motivations, and the challenges they face. More than 60% of the foundations provided detailed data on their current and historical mission investments.[31]

Although we cannot be sure what percentage of all US foundations that make mission investments are included in this sample, we do feel that the group represents a significant portion of foundation mission investing and therefore provides a good sense of overall practices. The foundations that participated in the qualitative interviews together hold 20% of all US foundation assets, and the subset that provided investment details comprises 12% of all assets.[32] As mission investing is a relatively new concept for many foundations and not yet widely practiced, we were pleased to capture the data of foundations representing such a significant percentage of the sector's total assets.

To encourage foundations to participate, we agreed that our analysis and reporting would be in the aggregate and that we would not share details about investors, investees, or investment deals in the report unless granted specific permission.

Data Collection Process

To make the data collection as easy as possible for foundations and to ensure that we collected data in its purest form, we asked participants to provide copies of the documents they use to track their mission investments rather than requiring them to fill out a standard template. Foundations therefore provided spreadsheets, term sheets, board updates, and a wide variety of other documents. Our team reviewed all these documents, extracted the information required for the research, and worked with each foundation to fill in gaps.

The research resulted in a rich picture of US foundations' mission investment activities and performance. However, due to the lack of comprehensive record keeping and reporting on mission investments at many foundations and a shortage of foundation staff available to research the data internally, some information simply was not available. Where appropriate, we note these gaps in the report.

As we explained in advance to each participating foundation, FSG provided much of the data collected for this study to the PRI Makers Network to populate its new searchable database of investment deals. This database will be available to PRI Makers Network members later this year and will serve as a learning tool for foundations that want to benefit from the mission investment experiences of their peers. Some foundations declined to be included in the database, but the majority agreed to furnish their data for this effort in addition to FSG's research.

We sincerely thank each foundation for its help in assembling and providing data. Many spent considerable time finding the information we requested and we truly appreciate their assistance.

[31] 39 private foundations, 17 corporate foundations, and 3 corporate foundations provided data on investments. Nearly all of the foundations that did not provide data cited a lack of staff available to gather the information requested.
[32] Based on foundation asset totals as reported in Foundation Center FC Stats, 2004

Participating Foundations

All participating foundations were interviewed for this study. Foundations shown in bold type also provided detailed data on their mission investments.

- **Altman Foundation**
- **The Annie E. Casey Foundation**
- **Barberton Community Foundation**
- **Baton Rouge Area Foundation**
- Bill and Melinda Gates Foundation
- Blandin Foundation
- **The Boston Foundation**
- Butler Family Fund
- **California Community Foundation**
- The Carlisle Foundation
- **Claude Worthington Benedum Foundation**
- **The Cleveland Foundation**
- Columbia Foundation
- **The Columbus Foundation**
- **Community Foundation for Muskegon County**
- **Community Foundation of Greater Greensboro**
- **Community Foundation of Herkimer and Oneida Counties**
- **Community Foundation of North Central Washington**
- **Community Foundation of Sonoma County**
- **Conrad N. Hilton Foundation**
- **Cooper Foundation**
- **Dakota Foundation**
- **The David and Lucile Packard Foundation**
- Deutsche Bank Americas Foundation
- Doris Duke Charitable Foundation
- **Dunn Foundation**
- Environment Now Foundation
- **Erich and Hannah Sachs Foundation**
- **F.B. Heron Foundation**
- **Ford Foundation**
- Friedman Family Foundation
- **Gaylord and Dorothy Donnelley Foundation**
- **Grand Rapids Community Foundation**
- **Gray Matters Capital**
- Helen Bader Foundation
- **Hoblitzelle Foundation**
- **HRK Foundation**
- **Hutton Foundation**
- **The Hyams Foundation**
- Idaho Community Foundation
- Island Foundation
- **Jacob and Hilda Blaustein Foundation**
- **Jacobs Center for Neighborhood Innovation**
- The James Irvine Foundation
- **Jewish Fund for Justice**
- **John D. and Catherine T. MacArthur Foundation**
- John S. and James L. Knight Foundation
- K.L. Felicitas Foundation
- **Kalamazoo Community Foundation**
- Lannan Foundation
- **The Lemelson Foundation**
- **Maine Community Foundation**
- **Marin Community Foundation**
- **Marion I. & Henry J. Knott Foundation**
- **Mary Reynolds Babcock Foundation**
- **McCune Foundation**
- Meadows Foundation
- **Melville Charitable Trust**
- **MetLife Foundation**
- **Meyer Memorial Trust**
- Minneapolis Foundation
- **Naomi and Nehemiah Cohen Foundation**
- New Hampshire Charitable Foundation
- Northern Michigan Foundation
- Northwest Area Foundation
- O.P. and W.E. Edwards Foundation
- Oregon Community Foundation
- Pacific View Foundation
- Phil Hardin Foundation
- **The Pittsburgh Foundation**
- **The Prudential Foundation**
- **Rasmuson Foundation**
- Rhode Island Foundation
- Robert R. McCormick Tribune Foundation
- Robert Wood Johnson Foundation
- **Rockdale Foundation**
- **The Rockefeller Foundation**
- Rosamond Gifford Charitable Corporation
- **S. H. Cowell Foundation**
- San Francisco Foundation
- Skoll Foundation
- **Stranahan Foundation**
- **Vermont Community Foundation**
- **Wachovia Foundation/Regional Community Development Corporation**
- Weeden Foundation
- **Wieboldt Foundation**
- **The William and Flora Hewlett Foundation**
- **William Penn Foundation**
- Winthrop Rockefeller Foundation
- Anonymous Foundations (3)

Several other organizations informed our research through interviews and provision of data but we did not include them due to the way they function as intermediaries for other foundations (Rudolf Steiner Foundation and The Calvert Foundation).

Asset Classes Defined

Debt Mission Investments

Conditional Investments

- **Loan Guarantee:** Pledge of financial resources to guarantee payment of a loan by a third party borrower. Loan guarantees enable borrowers to access funds that they otherwise could not and may also reduce the interest rates paid. Although the full amount of the guarantee is encumbered through the period of the guarantee, the foundation does not disburse funds unless the pledge is called and can continue to earn investment returns on these funds until needed. The amount of a loan guarantee is not an eligible distribution and therefore does not count in a private foundation's 5% payout requirement.
    - *Example:* A foundation works with a local bank to guarantee low-interest rate student loans for local youths who otherwise have few education funding options. Leveraging its funds in this way provides significantly greater resources to students than just awarding one-time scholarships.
    - *Example:* A foundation guarantees a loan from a bank to a nonprofit for purchasing a building, enabling the nonprofit to secure a lower interest rate.
- **Recoverable Grant:** A grant to an organization with a commitment from the investee to repay under specified circumstances. In some cases, repayment is required if certain milestones are met. In others, the repayment amount is eliminated (all or in part) when certain milestones are met. The transaction is treated as a grant until recovered.
    - *Example:* A foundation makes a recoverable grant to a housing agency to help finance the cost of a site plan application to a zoning and planning commission. If the project is approved and financing is secured, the housing agency repays the grant.
    - *Example:* A foundation makes a recoverable grant to a new social enterprise, with an agreement that if the social enterprise reaches profitability milestones it will repay the grant.

Deposits

- **Insured Deposit:** Funds placed in a depository institution (typically a Community Development Bank or Credit Union) earning a set rate of interest. Funds are insured by governmental agencies.
    - *Example:* A foundation invests in a Certificate of Deposit at a community development bank. The interest on this investment is market-rate.
- **Linked Deposit:** Funds placed in a depository institution (typically a Community Development Financial Institution) in exchange for a commitment from the institution to provide low-interest loans to qualified/specified borrowers.
    - *Example:* A foundation makes an investment in a Certificate of Deposit at a community development bank with the understanding that the funds will be used to provide loans to local businesses in order to spur economic development and job creation. The bank pays 1.5% interest to the foundation and charges 3.5% interest to the businesses, a below-market rate.
    - *Example:* A foundation makes a deposit in a community development bank at a below-market rate in order to capitalize a loan fund administered by the bank that focuses on redevelopment of the city's central business district.

Loans

- **Loan (Senior or Subordinated):** Funds provided to an organization with a commitment to repay the principal within a set period of time plus a specified rate of interest. Loans can have senior or subordinate status, affecting the lender's priority of repayment over other creditors.
    - *Example:* A foundation makes a loan to a childcare center to enable it to purchase a building instead of continuing to pay rising rents.
    - *Example:* A foundation makes a loan to capitalize a microfinance institution that provides micro-loans to women entrepreneurs.

- **Line of Credit:** A specified amount of unsecured credit extended to an organization for a specified time period, typically with a set amount of interest for the time until repayment. As funds are repaid, the organization can re-borrow funds.
    - *Example:* A foundation provides a line of credit to a biological research institution to finance ongoing operating expenses.
    - *Example:* A foundation provides a credit line to a local land trust to finance periodic purchases of land for preservation.
- **Loan Fund (Senior or Subordinated)**: Fund comprised of a pool of senior or subordinated loans. A loan fund investment entails less risk than an individual direct loan. Loan funds can have senior or subordinate status, affecting the lender's priority of repayment over other creditors.
    - *Example:* A foundation invests in a loan fund providing mortgages to low-income homeowners.
    - *Example:* A foundation invests in a loan fund focused on charter schools' facility development.

Fixed Income Securities

- **Bond:** A security that pays a specific interest rate, such as a bond, money market instrument, or preferred stock (typically individual bonds in our study). Can be issued by public, private, or government/municipal entities.
    - *Example:* A foundation invests in a bond issued by a development bank for rural cooperatives.
    - *Example:* A foundation purchases California Stem Cell Research and Cures Bond Anticipation Notes (BANs) to provide interim funding for research and training grants.
- **Bond Fund:** Mutual fund that invests in government and corporate bonds, and other bond investments. Provides an ongoing income stream.
    - *Example:* A foundation invests in a bond fund comprising community development bond offerings.
- **Mortgage Backed Securities:** Bond with cash flows that are backed by a pool of homeowners' mortgage payments.
    - *Example:* A foundation invests in a security backed by a pool of loans to low- and moderate-income borrowers to purchase homes across the southern US.
- **Other Asset Backed Securities:** Bonds backed by a pool of financial assets (e.g., accounts receivables, credit card debt, or other credit) that cannot easily be traded in their existing form. Through pooling, these illiquid assets can be converted into instruments that can be traded more freely.

Equity Mission Investments

Real Estate

- **Real Estate (individual investments):** Purchase of real estate and/or funding of construction of real estate. Foundations often buy buildings and lease them at low rates to nonprofits.
    - *Example:* A foundation focused on strengthening the local nonprofit sector purchases a building and rents it out at below-market rates to nonprofit organizations
    - *Example*: A foundation purchases land and develops a building for use by a university research center, charging below-market lease rates until the cost is recovered and then transferring ownership of the university.

- **Real Estate Fund:** A fund that invests in residential and/or commercial real estate, typically in low-income areas.
    - *Example:* A foundation invests in a real estate fund focused on purchasing and developing commercial or mixed-use real estate to spur economic development in a targeted area.

Public Equity

- **Public Equity Fund:** Fund that purchases stock in public companies using screens for inclusion (positive screening) or exclusion (negative screening) based on social criteria. (Although screening is a mission investing approach, only a fund that uses positive screens linked to the foundation's mission qualifies as a mission-related investment.)
    - *Example:* A foundation focused on environmental protection invests in a screened mutual fund that includes only companies with strong environmental records.
    - *Example:* A foundation focused on human rights invests in a screened mutual fund that includes only companies with strong human rights and labor relations records.
- **Direct Public Equity (investment in individual companies):** Purchase of stock of individual publicly traded companies.
    - *Example:* A foundation with an environmental protection mission purchases shares of a company that produces environmentally-friendly products.
    - *Example:* A foundation with an environmental protection mission purchases shares of a company with a record of poor environmental practices in order to advocate as a shareholder for new environmentally responsible business practices.

Private Equity

- **Direct Private Equity:** Investment in a private company, whether a traditional for-profit company, a social enterprise, or a socially focused financial enterprise such as a microfinance institution.
    - *Example:* A foundation focused on environmental protection makes an early-stage direct investment in a private company developing technology for cleaner fuel usage.
    - *Example:* A foundation focused on addressing a major disease invests in an early-stage private biotechnology company conducting research on potential cures.
- **Private Equity Fund:** A fund that buys majority stakes in post-early-stage companies or business units to restructure their capital, management teams, and organizations.
    - *Example:* A foundation invests in a private equity fund focused on companies in low income areas of the Bay Area of California in order to encourage economic development and job creation.
    - *Example:* A foundation invests in a microfinance equity fund that provides equity capital to microfinance institutions worldwide.
- **Venture Capital Fund:** A fund that buys equity stakes in early-stage small and medium-size enterprises with strong growth potential.
    - *Example:* A community foundation invests in a venture capital fund that provides capital and technical assistance to early-stage businesses in its state.
    - *Example:* A foundation focused on medical research invests in a venture capital fund that funds early-stage biotechnology companies.

Mission Investing Glossary

These definitions were informed by glossaries on the PRI Makers Network and Council on Foundations web sites.

Assets	Anything having commercial or exchange value owned by an organization.
Asset Class	Category of investment type (e.g., loan, venture capital fund)
Below Market-Rate Mission Investment	A mission investment with an expected financial return that is below market rate levels in order to achieve a mission-related benefit. For example, a foundation can provide a loan with zero or one percent interest to a nonprofit organization so that the nonprofit can allocate the resources it would otherwise spend on market rate interest payments to funding operations.
Blended Value	The Blended Value Proposition states that all organizations, whether for-profit or not, create value that consists of economic, social and environmental value components—and that investors (whether market-rate, charitable or some mix of the two) simultaneously generate all three forms of value through providing capital to organizations. See www.blendedvalue.org
Collateral	Personal or real property that the borrower pledges to assure re-payment of a loan.
Community Development Financial Institution (CDFI)	A financial institution whose primary mission is community development by providing credit, financial services, and other services to underserved markets or populations.
Community Foundation	A tax-exempt, nonprofit, autonomous, publicly supported, philanthropic institution composed primarily of permanent funds established by many separate donors of the long-term diverse, charitable benefit of the residents of a defined geographic area. Typically, a community foundation serves an area no larger than a state. Community foundations provide an array of services to donors who wish to establish endowed funds without incurring the administrative and legal costs of starting independent foundations.
Completed (investment status)	An investment is complete when it has either been repaid to the foundation or the foundation has written off some or all of the investment and no longer considers it open.
Corporate Foundation	A private foundation that derives its grantmaking funds primarily from the contributions of a profit-making business. The company-sponsored foundation often maintains close ties with the donor company, but it is a separate, legal organization, sometimes with its own endowment, and is subject to the same rules and regulations as other private foundations.
Credit grading / risk rating	Formal evaluation of an organization's credit history and capability to repay obligations.
Debt	An amount owed for funds borrowed. Generally, debt is secured by a note, bond, mortgage or other instrument that states the repayment and interest provisions.
Default	Failure to meet the terms of an obligation
Depreciation	The systematic allocation of the acquisition cost of long-lived or fixed assets to the expense accounts of particular periods that benefit from the use of the assets. Depreciation is a non-cash expense.
Due diligence	The process of evaluating the opportunities and risks of a particular investment, including the careful confirmation of all critical assumptions and facts presented by a borrower. This includes verifying sources of income, accuracy of financial statements, value of assets that will serve as collateral, the tax status of the borrower, and other material information.

Endowment Fund	An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted.
Equity	Cash invested by owners, developers, or other investors in a project. Equity investments typically take the form of an owner's share in the business, and return on equity involves a share in the profits. Evidence of business equity is usually in the form of shares of stock.
Fiduciary Duty	The legal responsibility for investing money or acting wisely on behalf of another. Managers of charitable entities have fiduciary obligations to the charity.
Form 990	IRS form filed annually by public charities and private foundations (990-PF). The IRS uses this form to assess compliance with the Internal Revenue Code. Both forms list organization assets, receipts, expenditures, grants, program-related investments and compensation of officers.
Grant	An award of funds to an organization or individual to undertake charitable activities.
Independent Foundation	These private foundations are usually founded by one individual, often by bequest. They are occasionally termed "non-operating" because they do not run their own programs. Many large independent foundations, such as the Ford Foundation, are no longer governed by members of the original donor's family but are run by boards made up of community, business and academic leaders.
Intermediary	A financial intermediary raises funds from depositors or investors, including individuals and organizations, and invests these funds to other individuals and organizations. Intermediaries can be non-profit or for-profit.
Jeopardy Investment	An investment that risks the foundation's ability to carry out its exempt purposes. Although certain types of investments are subject to careful examination, no single type is automatically a jeopardy investment. Generally, a jeopardy investment is found to be made when a foundation's managers have failed to exercise ordinary business care and prudence. The result of a jeopardy investment may be penalty taxes imposed upon a foundation and its managers. (see Program-Related Investment)
Market-Rate Mission Investment	A mission investment with an expected financial return that approximates the average risk-adjusted rate of return of a similar investment with no mission criteria.
Mission Investing	The practice of using financial investments as tools to further the investing foundation's mission. These tools, mission investments, provide a unique and flexible complement to grants, the conventional philanthropic device. Mission investments can take the form of debt or equity and can be funded by either program or endowment funds.
Open (investment status)	An investment is open if it has not yet been fully repaid or written off by the investor.
Opinion letter	That part of an audit in which the accountant gives his/her opinion as to whether or not the financial statements are in accordance with generally accepted accounting principles and whether or not the financial statements represent fairly the financial position and change in financial position of the organization.
Mission Investments	Investments made with the deliberate intention of achieving a social benefit tied to the foundation's mission and to recover the principal invested or earn a profit. Mission investments are extremely varied. They can be made using either program or endowment dollars and can be a wide range of debt or equity investment types.
Operating Foundation	Also called private operating foundations, operating foundations are private foundations that use the bulk of their income to provide charitable services or to run charitable programs of their own. They make few, if any, grants to outside organizations. To qualify as an operating foundation, specific rules, in addition to the applicable rules for private foundations, must be followed. The Carnegie Endowment for International Peace and the Getty Trust are examples of operating foundations.

Payout Requirement	The minimum amount that a private foundation is required to expend for charitable purposes (includes grants and necessary and reasonable administrative expenses). In general, a private foundation must pay out annually approximately 5 percent of the average market value of its assets. Community foundations are not subject to a payout requirement.
Principal	The basic amount of a loan, notwithstanding interest or other premiums.
Prime rate	The interest rate banks charge to their most credit-worthy corporate customers.
Private Foundation	A nongovernmental, nonprofit organization with funds (usually from a single source, such as an individual, family or corporation) and program managed by its own trustees or directors, established to maintain or aid social, educational, religious or other charitable activities serving the common welfare, primarily through grantmaking. U.S. private foundations are tax-exempt under Section 501(c)(3) of the Internal Revenue Code and are classified by the IRS as a private foundation as defined in the code.
Program Funds	Foundation assets that are allocated each year for philanthropic activities.
Program Officer/ Program Staff	Also referred to as a corporate affairs officer, program associate, public affairs officer or community affairs officer, a program officer is a staff member of a foundation or corporate giving program who may do some or all of the following: recommend policy, review grant requests, manage the budget and process applications for the board of directors or contributions committee.
Program-Related Investments (PRIs)	Mission investments made by private foundations that meet certain guidelines set forth by the US Internal Revenue Service. Based on the Tax Reform Act of 1969, private foundations must avoid making investments that might jeopardize the foundation's ability to carry out its mission. The IRS does make an allowance, however, for debt or equity "program-related investments" that might have higher than normal risk levels if these investments met three criteria: ▪ "The primary purpose is to accomplish one or more of the foundation's exempt purposes, ▪ Production of income or appreciation of property is not a significant purpose, and ▪ Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose."[33] These IRS regulations do not apply to community foundations, as they are classified as charitable organizations, not foundations.
Recourse	The right to demand payment from the borrower. In a full recourse loan, the lender has the right to take any assets of the borrower if the loan is not repaid. In a limited recourse loan, the lender can only take assets named in the loan agreement. In a non-recourse loan, the lender's rights are limited to the particular asset financed by the loan.
Screening	The use of criteria or "screens" as parameters for mutual funds of public equity (commonly known as socially responsible investment or SRI funds). Screens can be positive (determine which investments to include) or negative (determine which investments to exclude) and are based on social criteria, typically Social, Environmental and Governance.
Security	A pledge of value to assure the performance of an obligation or the repayment of a debt. Security on a loan can include real estate, personal property, stocks, and mortgages.
Shareholder Advocacy	Advocating as a shareholder to positively influence a corporation to change a behavior
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 utilizing social, environmental and corporate governance criteria for selecting public equity investments, usually in screened mutual funds.

[33] www.irs.gov

Sources for Additional Information

General

- Blended Value (www.blendedvalue.org): *Collection of publications on blended value investing.*
- The Community Investing Center (www.communityinvest.org): *A project of the Social Investment Forum Foundation and Co-op America, this web site provides information for community development investors and a comprehensive database of CDFIs.*
- Ragin, Luther. "New Frontiers in Mission Related Investing." *The F.B. Heron Foundation*, 2004.
- Social Investment Forum (www.socialinvest.org): *A national nonprofit membership association promoting socially responsible investing.*
- "2003 Report on Socially Responsible Investing Trends in the United States" *Social Investment Forum*, December 2003.
- Tasch, Edward, Dunn, Brian. "Mission-Related Investing: Strategies for Philanthropic Institutions" *Investors' Circle*, May, 2001.

Targeted Investments

Educational and networking resources

- Associations/Organizations
  - PRI Makers Network**:** www.primakers.net
  - Neighborhood Funders Group (www.nfg.org): *A national network of foundations and philanthropic organizations supporting community-based efforts that improve economic and social conditions in low-income communities. NFG provides information, learning opportunities, critical thinking and other professional development activities.*
  - The Nonprofit Centers Network (www.nonprofitcenters.org): *A community of Multi-tenant Nonprofit Centers and their philanthropic, government, academic and real estate partners. The Network provides education and resources for the creation and operation of quality nonprofit office and program space.*
  - Investors Circle (www.investorscircle.net): *Membership association of investors focused on providing capital to entrepreneurial companies that enhance bioregional, cultural and economic health and diversity.*
- Books
  - Baxter, Christie. "Program Related Investments: A Technical Manual for Foundations" Jossey-Bass, 1997.
  - Nober, Jane. "Economic Development: A Legal Guide for Grantmakers" Council on Foundations, 2005.
  - "The PRI Directory: Charitable Loans and Other Program-Related Investments by Foundations", 2nd edition, Foundation Center, August, 2003.
- Articles
  - Brody, Francie, McQueen, Kevin, Velasquez, Christa and Weiser, John. "Current Practices in Program-Related Investing." *Brody Weiser Burns*, 2002.
  - Brody, Francie, Velasquez, Christa. "Should We Consider a PRI?" *Brody Weiser Burns*, 2002.
  - Brody, Frances, Weiser, John, Miller, Scott. "Matching Program Strategy and PRI Cost" *Brody Weiser Burns*, 1995.
  - Carlson, Neil. "Program-Related Investing: Skills and Strategies for New PRI Funders", Grantcraft, 2006.
  - The CDFI Data Project, "Community Development Financial Institutions: Providing Capital, Building Communities, Creating Impact." 2004.
  - Chernoff, David. "Program-Related Investments: A User-Friendly Guide" (available on the PRI Makers Network web site: www.primakers.net).
  - Emerson, Jed. "Where Money Meets Mission: Breaking Down the Firewall Between Foundation Investments and Programming", Stanford Social Innovation Review, Summer 2003.
  - Emerson, Jed, Bonini, Sheila. "The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation", blendedvalue.org, October, 2003.
  - Emerson, Jed, Spitzer, Joshua, Mulhair, Gary "Blended Value Investing: Capital Opportunities for Social and Environmental Impact", World Economic Forum, March, 2006.
  - Emerson, Jed. Freundlich, Timothy, Berenbach, Shari. "The Investor's Toolkit: Generating Multiple Returns Through a Unified Investment Strategy" blendedvalue.org, Summer, 2004.
  - Ford Foundation. "Investing for Social Gain: Reflections on Two Decades of Program-Related Investments" 1991.

- Web sites
  - xigi.net: *Currently in beta testing, this web site offers a blogged dialogue among social investors, investees and intermediaries. It aims to provide a deal database of entities and offerings that show deal sizing, terms and other data such as relationships between social investment actors.*

Information on investments and intermediaries

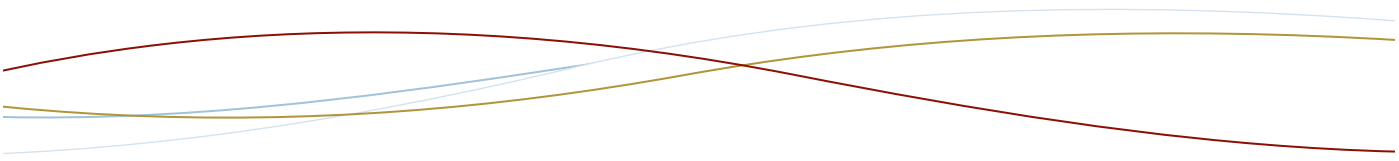
- CARS (www.communitycapital.org/financing/cars.html): *CARS™, the CDFI Assessment and Rating System, is a comprehensive, third-party analysis of community development financial institutions that aids investors and donors in their investment decision-making.*
- CDFI Data Project (http://www.cdfi.org/cdfiproj.asp): *Collaborative initiative with 517 CDFIs to create a data collection and management system for and about the community development finance field. Includes data on CDFIs by location and focus, investment activity and performance.*
- Community Development Venture Capital Alliance (CDVCA) (www.cdvca.org): *Trade association of over 100 community development venture capital funds.*
- The Community Investing Center (www.communityinvest.org): *A project of the Social Investment Forum Foundation and Co-op America, this web site provides "how-to" guidance for community development investors and a comprehensive database of CDFIs.*
- The MIX Market (mixmarket.org): *This web site provides profile and performance data on microfinance funds and institutions and enables users to search for funds by geography and fund type.*
- Opportunity Finance Network (www.opportunityfinance.net): *Network of 160+ CDFIs, active in financing, capacity building, and policy.*

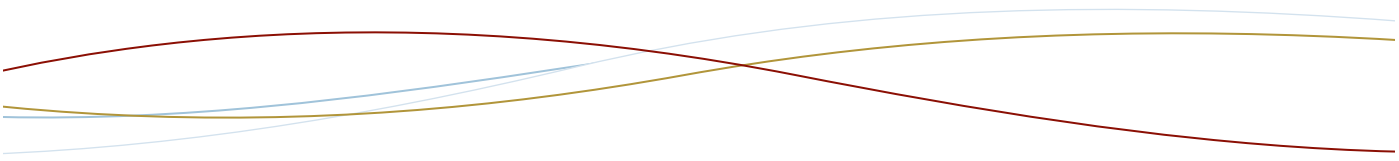
Screening / SRI Funds

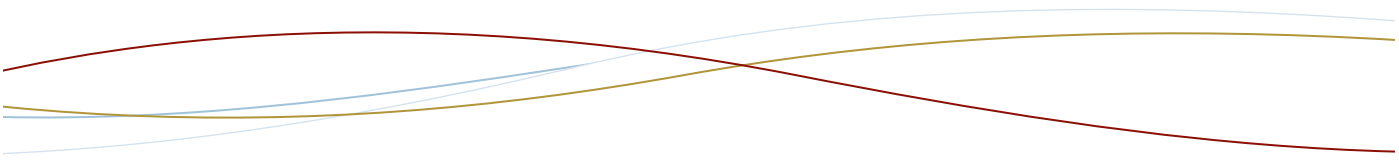
- Ceres (www.ceres.org): N*ational network of investors, environmental organizations and other public interest groups working with companies and investors to address sustainability challenges such as global climate change.*
- Social Funds (www.socialfunds.com): *Web site with information on SRI mutual funds, community investments, corporate research, and shareowner actions.*
- SRI Studies (www.sristudies.org). *Collection of studies on socially responsible investing.*
- UN Principles for Responsible Investment (www.unpri.org): *An initiative of UNEP Finance Initiative and the UN Global Compact, these principals provide guidance for considering environmental, social, and corporate governance (ESG) issues in investing decisions.*

Shareholder Advocacy

- As You Sow Foundation (www.asyousow.org).
- Foundation Partnership on Corporate Responsibility (www.foundationpartnership.org).
- Lipman, Harvey. "Meshing Proxy With Mission" *Chronicle of Philanthropy*, May 4, 2006.
- MacKerron, Conrad, Bauer, Doug. "Unlocking the Power of the Proxy." *Rockefeller Philanthropy Advisors, As You Sow Foundation*, 2004.







FSG SOCIAL IMPACT ADVISORS

Boston • Geneva • San Francisco • Seattle