

# MISSION-RELATED INVESTING

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## **A Workshop for Foundations**

**with detailed examples from the field of Community Investing**

Sara Olsen

Woody Tasch, editor

**O**n October 31–November 1, 2003, the Investors' Circle Foundation hosted a workshop on Mission Related Investing highlighting Community Investing. The program provided foundation executives a peer-learning forum, facilitated by a faculty of leading practitioners, to explore how Mission Related Investing can complement their grantmaking objectives in community development. This paper provides an overview of the proceedings, and may serve as a starting place for others interested in this approach to foundation asset management.

INVESTORS' CIRCLE



*Venture Capital for a Sustainable Future*

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*Sara Olsen*

## **About the author and editor:**

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## INTRODUCTORY REMARKS

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*“The greatest legal accumulation of wealth in history.”*

That’s how one of the nation’s leading venture capitalists, John Doerr, referred to the growth of the personal computer and internet industries. Even after the correction of the past few years, massive new fortunes remain, and his epithet might be thought of as describing the entire 20th century, rather than merely the hyper-cyber-stratosphere that we call venture capital.

The philanthropic institutions that arose out of the last century’s historic explosion of financial wealth now stand on a new threshold.

Behind them is the conventional wisdom, the world that gave birth to industrialism and the modern corporation and global financial markets, and with them the “poor box” version of philanthropy—built upon the notion that after wealth is maximized, a portion of it can be deployed to remedy social and environmental problems.

Ahead of them is a new vision, the new world of social investing and shareholder advocacy and definitions of fiduciary responsibility that integrate accountability for long-term social and environmental impacts into the very wealth creation process itself.

I do not believe we have the luxury of another century of wealth maximization and philanthropy the old-fashioned way. In fact, it seems curious to me that in the new-fangled epoch of networks and billions of instructions per second, gigabytes, the earth rising over the moon and the gap between rich and poor big enough to drive 20,000 Hummers through, we still find comfort in notions of fiscal prudence that were developed when the world had 500 million inhabitants, Susan B. Anthony wasn’t even a glint in her father’s eye and there was no such thing as dirty movies or dirty bombs.

Mission Related Investing offers foundations tools for moving towards a new era of philanthropy.

To be sure, working across the boundary between grantmaking and investing poses significant challenges.

But the rewards are considerable. And, to my thinking, the need incontrovertible.

This workshop offered participants an opportunity to explore with a group of their peers questions surrounding Mission Related Investing in general, and Community Investing, in particular.

The quality of the faculty that came together to facilitate this day and a half program was evidence that this exploration is part of an important emerging dialogue, dialogue that will broaden and deepen in the coming years.

At the nexus of social investing, venture capital and philanthropy, Investors’ Circle has been for over 12 years supporting the risk-taking of a network of investors who have provided over \$95 million to over 150 early-stage companies addressing major social and environmental problems. This is the arena of “for-profit social enterprise.” We are still early in the process of defining it with greater precision and of developing new strategies for supporting it more effectively. But we can see clearly the power of entrepreneurial companies to steer the economy, and the society it serves, in a more sustainable direction.

We look forward to leveraging the collective experience of our network through collaboration with foundations, particularly those who are beginning to move across the divide between philanthropic purpose and investment management. In this movement lie powerful new tools for supporting social entrepreneurship, and, through it, a more socially just, ecologically sound future.

*Woody Tasch*

*Chairman, Investors’ Circle*

# STATE OF THE FIELD

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**Since** the early 1990s, social investing—investment strategies that integrate financial objectives with social and environmental objectives—has experienced substantial growth. Assets under management by screened mutual funds have grown to over \$2 trillion, community development financial institutions have matured, the field of social venture capital has emerged and shareholder advocacy programs have become more widespread.

Within the philanthropic community, however, only a few foundations, including the F.B. Heron Foundation, The Jessie Smith Noyes Foundation, Rudolf Steiner Foundation and VanCity Community Foundation, have undertaken institution-wide, sustained initiatives to integrate their program objectives with their asset management strategies. While many others are looking at various aspects of Mission-Related Investing (“MRI”), few have taken the plunge. This document is designed to increase the accessibility and adoption of an MRI approach to asset management.

Mission-Related Investment is the practice of aligning foundation asset investment with philanthropic mission. It enhances the philanthropic pursuit by considering whether and how the externalities generated by the foundation’s asset investment strategy may counter the foundation’s mission, and by judiciously harnessing the power of investment assets to drive positive social and environmental benefits.

Any foundation can undertake Mission-Related Investment, and with it can generate the same financial performance it would seek through a mainstream investment strategy, if it so chooses.

In the Foundation Workshop, Rob Bowers of Cambridge Associates and John Ganzi of the Kenan-Flagler Graduate Business School at the University of North Carolina presented an initial overview of the field.

## Financial Risk and Return

Mission-Related Investing is more viable and established than most foundation investment officers, program staff or Trustees realize. According to Ana Thompson of the Charles and Helen Schwab Foundation, “People translate MRI as promoting spending down the corpus, but it need not be that. Market rate returns are possible.” Rob Bowers added, “Distinct risk-reward relationships, that are predictable and measurable, definitely exist.”

That competitive returns are achievable is largely due to the great diversity of options now available to investors using an MRI strategy. As Ganzi and Bowers testified, both in terms of variety and flexibility, Mission-Related categories and instruments are on par with those of traditional investing strategies.

### Major MRI categories include:

- **Shareholder Advocacy**, in which a company’s shareholders exercise their voting rights and relationships to encourage management to adhere to a set of socially responsible investment guidelines.
- **Screening**, in which certain corporate securities are included or excluded from a portfolio based on social or environmental criteria.
- **Private Equity Investing**, whereby investments are made in private companies or venture capital funds that generate both financial and social returns.
- **Lending**, whereby loans are made to organizations that offer a specific kind of social return and a financial return, usually below-market.

### MRI instruments are also quite diverse, and include:

- **Market-Rate, Public Debt and Equity** (SRI Mutual Funds) such as the Calvert Social Index Fund and Domini Social Equity Fund, which use social and environmental screens to assemble broadly-diversified portfolios of companies with responsible business practices.

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- **Insured Deposits**, which are deposits in financial institutions that are insured by the Federal Deposit Insurance Corporation (FDIC). They typically have a community development purpose, but may have other social purposes. An example is Shorebank Corporation.
- **Venture Capital Funds** that target conventional market rates of return but focus on industries with inherent social benefits, such as renewable energy, environmental technologies, health care and education-related information technologies. Examples include Commons Capital, Expansion Capital Partners and Solstice Capital.
- **Community Development** Venture Capital Funds which typically make investments targeted at specific economically disadvantaged regions or populations, and which may target slightly lower financial returns but which also explicitly target specific social returns. Examples include Northeast Ventures, which invests in businesses based in northeastern Minnesota with the goal of diversifying the economic base and increasing jobs in the region, and JP Morgan Chase Community Development Group, an investment program whose mission is to expand access to capital in low- and moderate-income communities by women- and minority-owned businesses.
- **Program Related Investments** (“PRI”), a legal term for debt or equity investments made by private foundations to nonprofits or for-profits with the chief purpose of advancing a social mission. Technically, PRIs are exceptions to the “jeopardizing investment” rule, and count against the foundation’s payout. Typically they are made at less than risk-adjusted rates of return. Although it is a legal requirement that the purpose of the investment be charitable, it is not an explicit legal requirement that PRIs return below market rates. An example of a PRI is the investment made by the Ford Foundation to the New Hampshire Community Loan Fund, Inc.

to partially capitalize a revolving loan fund for loans to refinance, purchase and replace manufactured homes for low-income homeowners.

Despite myriad options, however, most traditional investors have been uncomfortable with Mission-Related Investing because they have had no way to evaluate its effect on financial performance. The Workshop clarified what is known about the relationship between social purpose and financial risk and return.

The bottom line: an MRI strategy can have no risk-return tradeoff when the focus of the strategy is principally SRI, mortgage backed securities and venture capital. With community investing instruments such as CDVC, community development bank deposits and loan funds, one is less likely to earn competitive financial returns, but more likely to earn disproportionate social returns.

The participants agreed that a sufficient amount of investments have been made over a long enough period to point to several facts:

- **Financial returns** in some asset classes are competitive. Financial returns competitive with conventional investment options are possible across a range of risk/return profiles. The options range from screened mutual funds offering market rates of return to debt vehicles that offer 1-4% return at relatively low risk, which could be compared to the current yield on municipal bonds.

In the socially-oriented venture capital marketplace, data are lumpier and assessment of competitive returns more difficult; however, a recent Investors’ Circle Foundation study of the investments made by its network of angels in early stage companies (the largest such study ever), conducted in collaboration with Harvard Business School and McKinsey & Co., indicated internal rates of return for the 10 years ending in 2003 of 5% to 14%. Some private equity

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funds with environmental focus have returned rates in the mid-twenties.

- **Many performance characteristics** are the same in social venture capital portfolios as those of traditional venture capital portfolios. Noted Woody Tasch, “The Harvard McKinsey study didn’t surface major differences in the portfolio characteristics of our portfolio of social venture capital deals and those of a typical VC fund portfolio. The percentage of write-offs was statistically about the same, as was the percentage of winners. However, the multiples returned by the winners were generally lower, as you would expect since there is often less technology investing in social venture capital portfolios.”

- **Environmental screening** can be done without hurting returns. “If one believes in active management, an environmental overlay on an entire portfolio need not diminish returns,” according to Cambridge Associates’ Rob Bowers. However, some evidence suggests that environmental screens correlate with higher highs and lower lows than the average portfolio. “Most studies on funds that proactively select for environmental investments have shown that they have greater variances to their benchmarks—more up in up times, more down in down,” said John Ganzi of Keenan Flagler.

- **Community investments** may be less susceptible to boom-bust cycles that affect other sectors. “The normative returns for lower tech businesses are not as high for some of those businesses that do go through big cycles,” said Bowers, “so while the volatility may not be there, typically the upside is also more limited.”

- **Options abound.** Some investors are comfortable accepting an explicitly discounted financial return in order to enhance social returns. Others pursue competitive returns or seek to minimize the possibility of “social discounts” through diversification.

Because of the range of MRI options, investors can deliberately set levels of expected financial and social

returns. Case studies were presented to illustrate several of these.

### Case Study: The Rudolf Steiner Foundation

The Rudolf Steiner Foundation has been a leader in exploring the potential of MRI since it made its first loan in 1984, enabling investors to align their economic decisions with their values. Today the foundation has assets just above \$70M, divided between a community investment loan fund and donor advised funds.

RSF’s Community Investment Fund is an interest-bearing fund pooled from investments of over 800 individuals and organizations that want their money to be working directly in socially constructive ways. From this fund, RSF provides debt financing directly to mission-aligned projects. This direct linkage, as opposed to investing via intermediary funds, allows RSF to develop a relationship with investees that enhances the foundation’s understanding of the project’s social value, and equips RSF to validate the social value created, which in turn provides RSF’s investors greater transparency.

RSF also works with philanthropic clients to establish donor advised funds that are used more creatively than for grantmaking alone. They have enabled RSF to pilot special-purpose and higher-risk lending programs, such as the Fair Economies Program, which supports the early stage development of business models in environmentally friendly industries. This program has invested in eight companies to date, both for-profit and non-profit, including Organic Bouquet, Inc, which created the USDA- endorsed organic category for flowers and supports the conversion of conventional growers to organic methods safer for farm workers and the environment, and Yachana Gourmet, a chocolate company in Ecuador whose practices preserve rainforests and provide fair trade compensation to the cocoa growers.

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“Our goal with RSF’s Community Investment Fund is to make community investing as safe as possible,” President Mark Finser stated. RSF has made more than \$70 million in loans over the past 5 years, of which \$30M has been repaid to date. “We’ve only had to take \$4,000 out of our loan loss reserve,” Finser observed, “which is a tribute to the projects, our due diligence and the hand-holding advisory work that our staff does. We’ve created the capacity within RSF to do almost all of the underwriting ourselves. When you’re hands-on it can give you compelling data that informs good decisions.” Over the past 20 years, four of RSF’s lenders have gone under, but recognizing the risk of these situations, the foundation had secured collateral and individual guarantors, which entirely covered the loan obligations.

Finser elaborated, “Each time a loan has gotten into trouble, we go to see where the community is, who’s around the deal who can help, and it’s amazing how projects can be turned around.” He noted that some private foundations place a portion of their liquid funds with RSF on a short-term basis. “While it’s here,” he says, “they know it’s doing good.”

Remarkably, it is not only the providers of capital but also its recipients who appreciate the mission-related benefits of such financing. “Borrowers actually say, ‘We want to be borrowing from you.’ They recognize that their debt service is empowering us to continue to do our mission,” said Finser.

RSF has developed a mechanism that taps the value inherent in community investing to reduce risk. Its borrowers cross-guarantee each other borrower from the fund, up to an amount limited to 5% of their own loan. No borrower guarantee has ever had to be called under this provision.

When asked how the source of funds impacts RSF’s due diligence and the level of risk they’re willing to take, Finser answered: “We started out more on the banking side with lending and borrowing. The philanthropic side came second. We can take more

risk on that side, when it’s our own money. We’ve had donor advised funds come into RSF for the reason that they want RSF to be taking these kinds of risks. They’re partnering with us to see some innovation.”

“Do you have any sense how much larger the administrative cost is than for a conventional fund?” asked Willy Osborn of Commons Capital. Finser replied, “RSF has about a 4 to 5% spread. You can see the difference in overhead for doing due diligence, follow-up oversight, and because of the network we build around each deal. We think our performance to date shows that it pays off in terms of lower risk and substantial social returns.”

### Social Returns in the Context of MRI

Mission Related Investing is premised on the idea that foundations can generate social returns not only through their grantmaking, but also through their investing. While most foundations view assets as a passive pool whose sole purpose is to generate income to fund grants, awareness is increasing that: a) there is an institutional contradiction in having assets invested at cross-purposes to philanthropic goals; and, b) Mission Related Investing can provide significant new tools for pursuing mission.

People often ask, “Why should I be investing when I can give?” Mission Related Investing offers a way beyond this either/or choice. Shari Berenbach of the Calvert Foundation outlined these core values for Community Investment, noting that they are synergistic with those of grantmaking:

- **Mutuality:** mutual obligations and respect
- **Enterprise:** harnessing the power of enterprise to generate surplus and resources
- **Accountability:** generating measurable outcomes and accountability for results
- **Self-reliance:** calling upon loan recipients to transform their own lives and repay debt

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- **Self-respect:** fostering self-confidence and dignity in investees
- **Sustainability:** returning and recycling capital, with the potential for broader and more lasting impact.

When investment performance expectations are juxtaposed with mission-driven values, social impact measurement becomes a core issue. Foundations bring a particular lens to this task. In grantmaking they are regularly engaged in impact assessment utilizing criteria other than financial performance, however, among the many challenges facing foundations is that, since grantmaking programs are not standardized, the development of standardized social return metrics is made even more complex. While foundations can develop internal standards or procedures for assessing the mission-related impacts of their own investments, broadly applicable approaches to social returns measurement that would enable performance evaluation of mission related investments industry-wide do not yet exist.

Berenbach asserted, “A proactive management tool set is needed to help investors and investees track their social performance and compare their performance to that of others.”

### **Case study: Pacific Community Ventures**

Pacific Community Ventures stands is one of the best examples of the rigorous use of social impact assessment to make key decision information transparent for MRI. Founded in 1999, PCV is a nonprofit that acts as the managing member of two venture capital funds, and provides business advisory services to investees and potential investees. Its mission is to provide technical assistance and capital to businesses that have the potential to bring significant economic gains to low-income communities throughout California.

PCV’s investments and assessment methodology are built upon the question, “If our capital is working well, what’s happening inside those companies that have a social change benefit? What’s happening to the employees while they are on the job?” Its metrics are correlated with wealth creation and economic stability for the targeted employee population. With annual surveys administered by a third-party consultancy, and quarterly updates administered internally, the organization tracks changes in four indicators:

- **Quality of jobs**
- **Marketable skills for employees**
- **Retention of those employees**  
(as opposed to job creation)
- **Employee wealth creation**

PCV’s social performance results are published in an annual comprehensive assessment, available at its website. Cumulatively from 2000-2002, a total of 633 designated employees (from low-to-moderate income zip codes or found through a qualified community development organization) were evaluated. Average hourly wages in PCV’s financed portfolio increased 16% from \$10.54 to \$12.19, so that by 2000, 71% of financed companies paid average hourly wages above the living wage of the region. PCV also tracks benefits, training, and wealth creation mechanisms, and has developed a job quality index to facilitate informed investment selection and development.

According to Penelope Douglas, accountability and transparency are essential. “It is very important that all of us rely on credible third party data to increase the credibility of social performance assessments. However, we clearly don’t have the tools... to give investors all that they need to easily be able to make decisions across an array of institutions like our own. As a field, we need to have more accountability around this.”

### Cultural and Structural Obstacles

*“There are few discussions as challenging or as empowering for a foundation board as the discussion that breaks down the Iron Curtain between asset management and grantmaking. And few discussions that have such potential to unleash new forces for positive social change.”*

— Jed Emerson, Hewlett Foundation

To those outside the field of philanthropy, the idea that foundations would engage in Mission Related Investing often seems self-evident. Consider the following vision:

Mankind’s greatest challenge is to help billions of people lead meaningful lives in ways that are socially and environmentally sustainable. One way to do this is to create investments that reward investors for what their capital helps accomplish in the real world.

Foundations are better suited than almost any other type of organization to do the risk and needs analyses and to demonstrate new sustainable investment methods. Few other organizations have goals that are so broad and long range. Few have more freedom to consider fundamental issues. And few have the freedom to act, which is denied to other financial institutions that must protect their current businesses or avoid becoming liable to those whose savings they manage. If foundations show the need for and the soundness of new sustainable investment techniques, other institutions that cannot pioneer them will adopt them out of their own self-interest. Demand for them will grow and the financial industry will produce more of them. In that growth cycle lies a big hope for the future.

Those within the ranks of professional philanthropy, however, immediately recognize that such visions of the potential for Mission Related Investing do not take into account barriers that are built into the corporate culture of foundations. Impediments to MRI exist on both sides of the philanthropic institution. Grant

managers don’t trust for-profit instruments as tools for meaningful social value creation. Asset managers don’t believe that MRI will provide a market rate of return.

Evidence of this was provided by Peter Arndt, founder of World Notes, who researched the number of foundations making PRIs, and found that just 254, or .004% of all foundations, make them. “I called them, and they said they didn’t have the staffs in place to manage or maintain them,” he said. Shari Berenbach said Calvert Foundation has “spent a lot of time thinking about why don’t they do it. Foundations are staffed and conceive of themselves as grantmakers. PRIs are perceived as risky because they’re outside their expertise. They are far more visible. If the loans don’t come back, it’s a more obvious failure than a grant.” If foundation investment staff is not in a position to take roles in a PRI program, new staff with relevant expertise may be required to enable the foundation to engage in them.

Though ironic, the bifurcation between social purpose and profit-maximization is typically as stark in foundations as it is in other financial institutions, since ‘making more so there is more to give away’ mitigates against integrating social objectives into investment strategies.

Nonetheless, in some institutions, the divide between granting and investing has begun to narrow. The F.B. Heron Foundation and the Jessie Smith Noyes Foundation, for example, have implemented investment policies and programs that aim to align asset management and mission in fundamental ways.

The process of bridging the cultural divide between the finance committee and program staff can be a source of new organizational energy and vision. The Noyes Foundation’s Statement of Fiduciary Responsibility is illustrative of this kind of vision, generating new perspectives on the role of the foundation in a larger process of cultural transformation:

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We recognize that our fiduciary responsibility does not end with maximizing return and minimizing risk.

We also recognize that economic growth can come at considerable cost to communities and the environment.

We believe that efforts to mitigate environmental degradation, address issues of social justice and promote healthy communities should be incorporated as part of business and investment decision making. We believe that management, directors, employees and investors should consider these social issues in the pursuit of financial objectives.

We believe that in light of the social, environmental and economic challenges of our time, fiduciary responsibility in the coming decades will dictate the integration of prudent financial management practices with principles of environmental stewardship, concern for community, and corporate accountability to shareholders and stakeholders alike.

We believe that foundations have a particular role to play in this process, seeing their mission not only in terms of the uses of income to fund programs, but also in terms of the ends toward which endowment assets are managed. We believe that it is essential to reduce the dissonance between philanthropic mission and endowment management.

Similarly, the Heron Foundation conceives of its mission-related investing as a “philanthropic toolbox” with a continuum of tools from grants to program-related investments and market-rate investments. Heron made its first PRI in 1997 and its first market-rate mission-related investment in 2000. Since then it has expanded its strategy so that 20% of its assets, above and beyond grants, are in mission-related investments.

Early on, Heron’s board developed a vision: “We will use the endowment to support actively and directly our mission,” asserting that “this straightforward notion is based on the simple recognition that all of the

Foundation’s assets exist to serve a charitable purpose.” The board came up with the concept that the Foundation was a “private community investment trust”—a fund actively using as many of its assets as can be prudently invested for community and economic development, often in concert with other institutional investors. It has found this concept a useful internal touchstone for decision-making.

### **Case Study: Northwest Area Foundation**

Northwest Area Foundation (NWAf) has just completed a three-year process of initiating a mission-related venture capital initiative. Today a \$400M foundation, the Northwest Area Foundation was founded in 1934 by Louis Hill, son of the Great Northern Railway’s founder, James. It serves eight states that were once connected by the Railway.

Nick Smith, founder and CEO of Northeast Ventures, a community development venture fund in Duluth, Minnesota, became a member of the NWAf board in the mid-nineties, and subsequently Chair of the Investment Committee. “This was very much a board that had accepted the idea of a total division between investing and grantmaking,” said Smith. “I would raise the idea of MRI, and most members of the board would say, ‘that’s a great idea: let’s get our program people to look into that.’ They could not initially see that this was about investing, that it was about the corpus, not the grants budget.”

The foundation turned to Investors’ Circle for assistance in framing an exploration of a mission related venture fund. Investors’ Circle produced a report and brought three consultants to NWAf to meet with the Investment Committee. Over the next year, the committee studied private equity and community development funds in the region, and then asked the Community Development Venture Capital Alliance (the industry association for community development venture capital) to synthesize all of the work into recommendations. Said Smith, “Eventually,

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we were able to lay out a path that the board could imagine moving down.”

The investment committee recommended that the foundation allocate \$10 million to a mission related venture fund, and issue a request for proposals for a fund manager who would match their allocation with an additional \$40 million from other investors. It was also recommended that the program budget include \$10 million in grants to build the capacity of community development NGOs in the region.

Said Smith, “These are very exciting first steps. But much work remains to be done, not only seeing if we can successfully launch the fund, but also continuing to manage the relationship between this dialogue in the Investment Committee and the foundation’s overall goals.”

“Mission Related Investing is a style, a strategy—not an asset class. Different opportunities to blend financial and social value exist in each asset class.”

# MRI APPROACHES AND EXAMPLES

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*“Mission Related Investing is a style, a strategy—not an asset class. Different opportunities to blend financial and social value exist in each asset class.”*

— John Ganzi, Kenan-Flagler Graduate Business School

Workshop faculty identified and discussed four key questions that must be answered by foundations considering MRI.

## **1. What percentage of assets should be devoted to MRI?**

Most foundations currently involved in MRI set a target percentage of assets and adopt an incremental approach to achieving this proportion over a number of years. “Taking little steps has freed us up to try it,” said Faith Brown of the Vermont Community Foundation. “It was helpful to realize that. It seems simple, but it was not obvious at the start.”

At the other end of the spectrum is VanCity Community Foundation, which supports affordable housing, employment development, and non-profit enterprises in British Columbia. At VanCity, every dollar is handled in a way that reinforces the foundation’s mission: some are invested directly in community development venture capital or loan funds, while others are invested in socially screened mutual funds.

Jennifer Johnstone of VanCity said, “Contrary to what people often think, donors are attracted to this. The reality is the opposite of what people fear might happen. People want to invest this way.”

During the 1990s, the Jessie Smith Noyes Foundation aimed to have all of their public securities in socially screened portfolios, and also implemented a mission-related venture capital program to which 5% of its assets were allocated. The foundation was the first institutional investor in the Domini Social Equity Fund. The foundation invested in unscreened mezzanine and hedge funds, however, since at the time no screened products existed in these asset classes. (Such products

have since been developed). Finally, the foundation utilized its voice as an active shareholder to influence Intel Corporation to be more responsive to the Southwest Organizing Project, a Noyes grantee that was engaged with Intel on issues of environmental justice and community right to know.

## **2. How can we assess social returns?**

It is no surprise that the most widespread social performance assessment practices involve counting things that are easy to count, such as the number jobs created by funded businesses or the number of units of low-income housing. In practice, the bulk of consideration of the social outcomes of an investment is done at inception, when the investee is assessed against a set of social objectives. Thereafter, most mission-related investors require updated social data to be reported annually by the funding recipient. In most cases there is little or no third-party verification of these reports.

Some investors do not see the need for explicit methodologies of social accounting for investments focused in sectors where social benefits are self-evident, such as renewable energy and community development. In these cases, social performance is presumed to be a corollary of business success.

A number of frameworks for assessing the social return of mission-related investment have been developed over the past several years. Several of these have been cataloged by the Rockefeller Foundation’s Double Bottom Line Project Methods Catalog, which aims to help entrepreneurs and investors determine what social impact assessment practices are most appropriate for their needs. The

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Methods Catalog diagrams nine methods used by both for-profit investors and engaged philanthropy funds investing in businesses with both social and financial goals. Two major categories emerged from the study:

- **Impact assessment methods** evaluate the social benefits that have actually been achieved or are projected as a result of the business' activities. One example is Social Return on Investment (SROI) analysis, which the Calvert Foundation uses in its Community Investment Note portfolio, and which has been calculated by several for-profit and nonprofit competitors in the Global Social Venture Competition.

- **Performance assessment methods**, which are designed to facilitate collection and management of day-to-day information about operations as they relate to targeted social outcomes. An example is the Social Return Assessment that Pacific Community Ventures developed for its portfolio, and the Balanced Scorecard developed by Kaplan and Norton, which has been modified to include consideration of social returns by a number of organizations including New Profit Inc.

The Methods Catalog includes a detailed discussion of how investors can choose an approach that meets their needs, as well as examples of the types of instruments different investors use to collect and assess information.

### 3. How can the “great divide” between program and investment sides of a foundation be overcome?

“The program staff alone does not have the leverage required to bridge the divide between the program and investment sides,” said Nick Smith. “The board’s role is critical.” Even the boards of progressive foundations are typically conservative when it comes to financial and technical issues, however, in large part because they rely heavily on investment experts who are not familiar with MRI.

A few steps may help those interested in MRI to build an effective organizational platform for this work.

- **Have the mission conversation first.** Joel Getzendanner, who helped design the Joyce Foundation’s investment strategy, observes that it is critical to have the mission conversation “at the very beginning of the process, to get clear on the vision, the rationale for doing it this way instead of the traditional way, and the game plan.”

- **Develop a shared values statement.** Before you can develop your investment strategy, you need a shared values statement to guide the organization. Using models like the The Noyes Foundation Statement of Responsibility, draft a values statement tailored to the specific history and needs of your organization.

- **Develop an investment policy.** Once there is clarity about the values around MRI, the next step is to write an investment policy that spells out the role of MRI with respect to your overall investment objectives and asset allocation.

- **Be conscious** about the choice of financial and legal advisors and the timing of their involvement. In many cases, advisors have opinions about social investing that may not be consistent with current approaches, metrics or models. “Virtually all people who did social investing 20+ years ago assumed it would result in poorer financial performance,” said former Solomon Brothers employee John Ganzi, “but times have changed.” Interpretations of legal standards of fiduciary responsibility as it pertains to MRI (and, in particular, to Program Related Investing, discussed below) vary considerably between attorneys.

### 4. What legal questions are posed by MRI?

So long as basic procedures of professional investing are followed—an investment policy and asset allocation strategy are in place, and documented due diligence is undertaken in choosing managers or individual investments—market-rate Mission-Related Investment poses no particular legal challenges. But if

## MRI APPROACHES AND EXAMPLES

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MRI strategies include Program-Related Investments (PRI) or other investments that do not seek first and foremost to deliver market rate returns, a number of legal and regulatory questions must be addressed.

Many foundation officers believe that they are prohibited, as fiduciaries, from making investments that are designed to deliver below-market rates of return. “The best piece that I have seen on this,” remarked Woody Tasch, “is an essay by William McKeown published in *The Social Investment Almanac*.” McKeown, an experienced attorney, lays out the logic by which a foundation fiduciary can clearly and carefully decide that it is not necessarily a breach of prudence or fiduciary responsibility to pursue investments that are expected, or even explicitly designed, to deliver below-market returns. Writes McKeown:

*Under the business judgment rule, the governing board of a corporation is free to use its own business judgment as to the use of corporate assets, as long as the board acts in what it believes to be the corporation’s best interests. Under this standard of care, in the absence of bad faith, fraud, or conflict of interest, the courts will not question the decisions, including the investment decisions, of boards of directors.*

The modern trend is to apply corporate law rather than trust principles in determining the liability of the directors of charitable corporations, because their functions are virtually indistinguishable from those of the ‘pure’ corporate counterparts. Thus, the standard of care applicable to the board of a charitable corporation is like that for the board of a business corporation.

The New York Court of Appeals stated in *Morris v. Scribner* (the case of St. Bartholomew’s Church):

*...As another court said so well, “(i)f the courts will not interfere with the determination of the*

*board of directors of a business corporation honestly and fairly arrived at, it certainly should not do so in the case of a religious corporation, the conduct of whose temporal affairs is often actuated by considerations which cannot be measured in dollars and cents...”(27)*

While *Morris v. Scribner* applies to religious corporations, the principle of applying the business judgment rule, and not the “prudent man” rule, applies to other charitable entities as well.

Program Related Investments are one subset of the investments that can be in this category. Their legal definition and the procedural requirements for implementing them are beyond the scope of this paper. A number of consultants and lawyers have developed specialization in this arena, however, and several foundations, including Ford and MacArthur, have implemented substantial PRI programs over many years. Generally speaking, to qualify as a PRI, an investment must be directly related to a grantmaking program, and should offer below-market return. “A good litmus test is to be able to say, ‘but for those dollars we couldn’t produce that drug, create that affordable housing project, and so on,’” said foundation attorney Eliot Green.

Situations that may present a gray area to regulators include cases where a PRI is not clearly mission-related, the financial return is not below-market, or the foundation does not have a controlling position in the investment. If a PRI is determined by the IRS not to qualify, the investment may be termed a “jeopardizing investment” and a tax applied.

The fundamental issue throughout is governance: make sure that the charitable mission for the nonprofit or project is not only preserved through the transaction, but that the investment documents clearly state this. “You have an obligation to make sure the PRI is functioning in a way that preserves the mission going forward,” said Green. “It is not uncommon five or six

## MRI APPROACHES AND EXAMPLES

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years down the road to find that the situation has changed dramatically, and that the for-profit motive has overtaken the mission. Careful oversight is necessary.”

John Ganzi recommended three steps to follow in making any Mission-Related Investment:

- 1) Document** how it relates to your mission;
- 2) Document** the due diligence supporting the investment decision; and
- 3) Undertake monitoring** to ensure that the investment continues to comply with mission-related objectives, including, when relevant, assessment of social returns.

A wide range of MRI options are available when investments advance mission in explicit, demonstrable ways and when appropriate due diligence and monitoring are implemented.

# IMPLEMENTING AN MRI STRATEGY: LESSONS LEARNED

*“Chewable chunks.”* — Shari Berenbach, Calvert Foundation

A successful MRI program will hinge on two processes: the program’s design and a process for tracking social returns.

## Design

In designing an MRI program, two basic questions need to be addressed: How will the execution of your MRI strategy be managed, and will MRI objectives be applied to the entire portfolio, to a specified percentage of assets, or to specific asset classes?

Management of an MRI program will involve ongoing collaboration between program staff and investment managers. Regular, structured dialogue will probably be necessary to address issues as they arise, and to build a solid foundation from which to manage expectations and assess performance.

While some foundations will undertake MRI portfolio-wide, most will probably follow the example of the Vermont Community Foundation, whose Faith Brown reports that they found success by moving into MRI incrementally. “We decided to invest at least 5% of our assets locally in Vermont.” The foundation designed an MRI pool with which to experiment, and reached its 5% goal by the end of 2003. Vermont Community Foundation outsourced due diligence on potential direct MRI investments.

For those considering venture capital as an MRI investment instrument, Gloria Lee of JP Morgan Chase’s Community Development Fund Group suggested the following additional set of questions:

**• How do you get diversification within your portfolio when you’re investing in venture capital?**

A third or more of a fund’s portfolio is typically written off, with overall returns driven very substantially by a

few winners. All successful venture portfolios depend upon sufficient diversification. If investing in funds, it is important to seek diversification by deal stage and industry sector.

**• How do you justify the time to complete due diligence when you may invest a very small portion of your assets?**

Because of the due diligence required, investing in venture funds can be expensive. Similarly, undertaking a direct venture capital program as part of an MRI strategy will be very expensive, since venture capital management fees reflect the active, hands-on nature of the business and its risks. Particularly for small, in-house programs, fees as a percentage of allocated assets will be high.

**• Are you undertaking additional risk in pursuit of social returns?**

While as yet there is no standardized answer to this question, it should be an on-going part of your framework of evaluation.

## Social Returns Tracking

There are not yet standardized metrics to assess social performance. “In ten to twenty years, the industry will be more mature and we will be able to use metrics developed today as benchmarks,” envisioned Jed Emerson. For the time being, though, focus on selecting and tracking a few specific performance metrics that correlate with the social outcomes the investee expects to generate.

## It is helpful to consider:

**• What specific outcomes,** financial and social, does the investment aim to achieve? Is this clearly articulated from the outset?

## IMPLEMENTING AN MRI STRATEGY: LESSONS LEARNED

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- **How is this tracked?** Is the system consistent, reliable, credible, and comprehensive?
- **What social impacts** have been realized per amount invested? Does this include what didn't succeed as well as what did?

In private equity and debt situations you will need the investee's cooperation to successfully track your social performance. Therefore, it is wise to begin the investment relationship by asking what social outcomes he or she hopes to generate. If you both value information about progress toward those outcomes, effective data collection is far more likely to occur. Said Penelope Douglas, "Setting expectations up front avoids tensions later on when your investee discovers that you expect them to collaborate with you in assessing social performance."

Finally, it is critical that ongoing monitoring of social performance be as strict as ongoing financial management. Unfortunately, as community investment and foundation consultant Tom Miller noted, this is not standard practice in any part of philanthropic financing, be it grants, PRI's, or other Mission-Related Investments. Nonetheless, several social venture funds and pioneering MRI foundations have developed social performance management frameworks that can serve as models.

# SUMMARY

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*“This is the most exciting thing going on in philanthropy today.”*

— Jennifer Johnstone, VanCity Community Foundation

The Foundation Workshop clarified the state of the art of Mission Related Investing.

## **Financial risk and return:**

- Mission-Related Investing, like Socially Responsible Investing, is a style, not an asset class. One can make every type of investment, from low risk/return debt, to high risk/return venture capital, and it can all be mission-related.
- With the availability of quality Mission-Related Investments, the definition of foundation fiduciary responsibility broadens considerably.
- It is not necessary to sacrifice financial return to find investments aligned with mission. However, to attain more direct social impact, investors may select MRI options that typically do not yield risk-adjusted returns.

## **Social return:**

- Social returns assessment is important both to foundations’ ability to implement sound MRI strategies, and to investees’ ability to attract more capital into such deals.
- While no standard methods for tracking social performance and assessing returns yet exist, several fledgling frameworks have been developed, offering a range of benefits in terms of cost effectiveness, comprehensiveness and credibility.

## **Implementation:**

- MRI can be approached incrementally.
- Documentation that clearly states social and financial performance expectations, and a regular system for evaluating performance against these expectations, is critical.

MRI offers foundations powerful new tools to achieve their missions. The strategy has potentially profound implications for environmental sustainability, international and community development, health equity, education, and many other missions. By applying a rigorous approach to the exploration of synergies between asset investment and grantmaking, foundation officers can and will unlock the potential of the massive capital resources they control.

# INDUSTRY FOCUS SECTION

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## Community Investing

### Mission-Related Investment Options and Opportunities in Community Investing

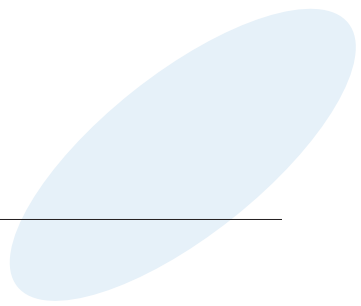
**This** is a companion document to the paper “Mission Related Investing: a Workshop for Foundations.” A primer on community investing, this paper provides an overview of the field, lays out the financial risk/return profiles of different investment options, and provides examples of some of the investors and funds active in the space today, including: JP Morgan Chase, which has a community development fund of funds that invests in venture capital funds; Boston Community Capital and Pacific Community Ventures, two community development venture funds; and the Calvert Foundation, which does community investment lending for individual and institutional investors.

INVESTORS' CIRCLE



*Venture Capital for a Sustainable Future*

# COMMUNITY INVESTING



*“Community investing is really about who owns. You really have to ask yourself, ‘what does success look like?’*

—Karla Miller, Northwest Area Foundation

Community investing (CI) is financing that creates resources and opportunities for economically disadvantaged people in the U.S. and overseas who are underserved by traditional financial institutions. Typically this investing supports:

- Affordable housing & childcare
- Locally-owned and minority-owned businesses
- Jobs that pay a living wage
- Health care
- Education and mentoring for small business owners

Philanthropists often ask, “Why should I be investing when I can give?” The core values for community investment are a different set than those that underlie a grant-giving approach.

- **Mutuality:** mutual obligations and respect
- **Enterprise:** CI harnesses the power of enterprise to generate surplus and resources
- **Accountability:** CI generates measurable outcomes and accountability for results
- **Self-reliance:** CI calls upon beneficiaries to transform their own lives and repay debt
- **Self-respect:** the investment process fosters self-confidence and dignity
- **Sustainability:** capital is returned and recycled, with the potential for far broader lasting impact.

These values are present in all types of community investments. The range of CI opportunities span the same spectrum as the broader Mission-Related Investing world, and are discussed in detail below.

<b>Assets in Community Investing, USA</b>	<b>(Billions)</b>
Screened Mutual Funds	\$2,010
Shareholder Activism (Unscreened Funds)	\$300
Community Development Finance Institutions (Including Community Development Venture Capital)	\$7.6
Private Foundation Program Related Investments	\$0.2
Total	\$2,317.8

**Mutual Funds.** Socially screened mutual funds come in all types. Because mutual funds are already familiar to most investors, they will not be discussed in detail here.

**Community Lending.** Many institutions are available for investment. Community banks, credit unions, development corporations and microcredit institutions target their funds in communities that are deprived of access to mainstream capital primarily due to depressed economic conditions, discrimination, or other systemic barriers. They offer loans at market rates and often provide technical assistance such as workshops on entrepreneurship, home buying, and job skills.

ShoreBank is an example of a community bank that has provided retail and commercial banking to specific low- to moderate-income neighborhoods in Chicago since the 1970s. A for-profit bank, it has a non-profit community development corporation affiliate, Shorebank Neighborhood Institute, which operates a job training and placement service to community residents, an individual savings program, and other programs designed to increase residents’ actual and potential wealth creation.

# COMMUNITY INVESTING

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A microcredit institution is ACCION International, which has provided loans, as low as \$100 in Latin America and \$500 in the United States, and business training to poor women and men who start their own businesses for over 30 years. The capital enables people to grow their own businesses and “earn enough to afford basics like running water, better food and schooling for their children.” Borrowers pay enough interest to cover the expense of making the loan. “In this way, each borrower helps finance the cost of lending to the next. The more people the program reaches, the more resources it has to reach even more people.”

“Community development loan funds operate in specific geographic areas and act as intermediaries that pool investments and loans provided by individuals and institutions, often at below-market rates, to further community development.” By investing in a financial intermediary like Calvert Foundation, the risk level of investing in community development is further reduced through portfolio diversification, professional management and credit enhancements, establishing in effect a fixed income option for investors.

Brownfields and Brownfirms. Brownfields redevelopment is subset of community investing in that its goal is to restore real estate that is toxic and has fallen into disuse. The EPA estimates that there are 400,000 to 600,000 brownfield sites in the U.S., only 20,000 to 30,000 of which have sufficient real estate investment value to interest mainstream investors.

Typically investors are primarily motivated by the very high rates of return that are possible. These investors buy, clean, and resell them for profit, often substantial. One example of a fund that invests in these deals is Brownfields Recovery Corporation, has completed 7 deals, each with an average internal rate of return above 30%.

John DeVillars of BlueWave Strategies, an advisory firm to brownfields developers that has worked with Brownfields Recovery Corp., noted that “Fundamentally, these are real estate deals. Cleaning up the environment and community development benefits are secondary.” Other defining criteria he identified for these often very complex deals are:

- **Most deals** require very patient capital.
- **This is a very politically intense field.** “The number of deals a firm does directly correlates with their political connections.”
- **Developers need** to have a very sophisticated understanding of risk management and risk transfer. “Brownfield sites go through an intense negotiation process between the seller and the prospective buyer.”

Successful development demands an experienced developer working with a multi-disciplinary team with expertise in remediation, real estate and policy. Contaminated sites are pooled and package to an investment bank to create a fixed income instrument.

Brownfirms redevelopment is a lesser-known area, but the rates of return and payout are even larger than in brownfields. It is a subset of private equity that involves of acquiring companies that are knowingly polluting (at levels lower than regulation), cleaning up the pollution, restructuring the management or business model (if needed), and selling for a profit.

Community Development Venture Capital (CDVC). These funds provide both investment capital and other resources to businesses with the potential to bring significant economic gains to low-income communities. They operate using a “double-bottom line” or “total return on investment” philosophy, seeking financial and social returns on investment.

CDVC funds usually have a 10-year life, wherein the activity over the first five years is investing and the last five is harvesting. Generally each fund will invest in 10

# COMMUNITY INVESTING: PROFILES

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to 20 portfolio companies over its life. Limited partners are entities that provide money to a venture fund. Fund sizes are much smaller than with traditional private equity funds, averaging about \$30 to \$150 million.

An example is the Reinvestment Fund Urban Growth Partners. A \$55 million fund, it is the second fund raised by this group and one of the largest CDFIs. Its investors include JP Morgan Chase, the Ford Foundation, the Annie E. Casey Foundation, the Open Society Institute, banks, insurance companies and the City of Philadelphia. Another example is ICB partners, a \$130 million fund based in New York. It is a joint venture between the traditional buyout firm that manages close to \$1 billion, American Securities, and the Initiative for a Competitive Inner City (ICIC). It invests in inner city businesses throughout the country.

The Community Development Venture Capital Alliance, a trade association for the industry, projects that CDVC will offer an internal rate of return of 8 to 12%. The Investors Circle network has invested over \$95 million in 150 early- and expansion-stage businesses and venture funds including CDVCs. A recent Investors' Circle Foundation study in collaboration with Harvard Business School and McKinsey & Company of these investments determined that the deals had an internal rate of return ranging from 5 to 14% over the past ten years.

To date, it appears that financial returns in community development venture capital are somewhat below market. Is the lower return offset by lower risk? The jury is still out.

Foundation grants and donor advised funds. Because foundation grants and donor advised funds are already familiar to foundation readers, they will not be described here.

## Profiles of Community Investment Vehicles

- **JP Morgan Chase  
Community Development Group**
- **Calvert Foundation**

- **Boston Community Capital**
- **Pacific Community Ventures**

## JP Morgan Chase Community Development Group

JP Morgan Chase Community Development Group is the community development corporation (CDC) of JP Morgan Chase, the bank. It employs about 160 people and in 2002 completed \$1 billion of lending and investing for the bank, all for community development purposes. The group is a separate business unit within the bank, and distinct from the corporation's charitable and foundation activities.

The CDG offers a full range of financial products including credit, investing (a relatively new but growing practice), and banking assistance and advisory services. A large component of the CDC's activity is in a fund investment program that invests in DBL and community investment funds. Generally, JP Morgan Chase invests as limited partner, providing the money to an investment fund. Investment funds usually have a 10-year life, wherein the activity over the first five years is investing and the last five is harvesting. Generally each fund will invest in 10 to 20 portfolio companies over its life.

CDG's investment program was established as a result of the firm receiving proposals that were not appropriate for grant giving, and that could not meet its lending criteria, but that offered social benefits in line with the Group's mission of community development. The firm started making investments in these proposals on a case basis in the early nineties. After several years, as deal flow increased, the CDG created a structured process and program to maximize its financial and social returns on investment.

Originally, although its mission had been access to capital, in practice that had meant debt capital. "The transition to equity was an innovation and a new experience," said Vice President and Investment

# COMMUNITY INVESTING: PROFILES

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Officer Gloria Lee. When CDG first started, its staff didn't have the appetite or experience to do direct investments, so they invested in funds. CDG formed its investment fund in 1998-1999, and today it is a \$130M portfolio with investment in three dozen community development venture funds primarily in the northeast and mid-Atlantic, with some in the southwest, and some national funds. Lee evaluates approximately 80 investment proposals each year, and invests in about 8 to 10 deals a year. The average investment size is \$1 to \$5 million. In any fund CDG invests in, there are typically 10 to 15 other investors. "We all know each other and the funds, there's a huge element of collaboration and trying to move the field together," she said.

The funds CDG invests in are all for-profits that are either owned by a nonprofit, or are joint ventures between a traditional private equity fund manager and a nonprofit fund manager. They target four broad groups that are underserved by mainstream capital markets and are optimal for the venture model:

- **Funds that target investing** to low and moderate-income communities (which may include CDVC funds).
- **Ethnic minority- and women-focused** funds, which invest in companies led or owned by people of color and/or women.
- **Funds that invest in small businesses** (private equity and venture capital), as a generator for jobs and economic development expansion.
- **Real estate private equity funds** that focus on inner city urban areas.

Lee provided this list of questions foundations should consider when contemplating community development venture capital as an investment strategy:

• **How do you get access** to the best funds, and the best CDVC funds? "One of the challenges is to be able to evaluate them well. One should consider the evaluation and weeding out process before getting into it."

• **How do you get diversification** within your portfolio, when you're investing in VC? "Anywhere from 20 - 33% of a fund's portfolio could be written off. To achieve diversification, we would suggest you invest in multiple funds, across different deal stages, investment strategies and with talented management teams."

• **How do you justify** finding the time to complete due diligence when you may invest a very small portion of your assets?

• **How do you evaluate traditional** and non-traditional risk? And how do you evaluate whether the fund manager is going to get the impact he wanted to get? Meaningful evaluation "is a huge success factor."

## Calvert Social Investment Foundation

*"We believe lack of access to reliable third party information [about social and financial performance] is keeping a lot of people from investing in this space."*  
— Shari Berenbach, Executive Director, Calvert Social Investment Foundation

Calvert Social Investment Foundation is a community development lender that bridges the divide between philanthropy endowments and community investment. It strives to create a level of confidence for investors, so they know they will get their funds back. "Building the confidence level is extremely important for the field," said Executive Director Shari Berenbach.

The foundation, though co-founded by the Calvert Group, Ltd., is separate from it. Calvert Group has a family of mutual funds, SRI screened funds, and a social venture program for early stage direct investment, while Calvert Foundation focuses on direct community investments. It offers a "safe debt" element to investors, which typically does not provide a market rate of return, but offers virtually no risk. "We are like the fixed income equivalent for community investing," said Berenbach.

The foundation's two principal activities are selling and managing a security called the Community

# COMMUNITY INVESTING: PROFILES

Investment Note (CIN), and partnering to help other institutions and investors do what we do. The Community Investment Note has 1,830 investors and \$84 million in assets and over 180 lendee organizations. Calvert Foundation also has a more philanthropic set of offerings, including a donor-advised fund.

Loans from Calvert Foundation to community-based financial intermediaries average \$300,000, but may be as little as \$50,000 or as high as \$1,000,000. Local lenders (such as Boston Community Capital, which is profiled below) then use this capital to invest in families outside the economic mainstream. When investing in microloan programs overseas like ACCION International, Calvert Foundation borrowers extend microloans as low as \$100.

**Social Return Assessment.** The foundation tracks the number of units of housing and jobs created by lendees in its CIN portfolio as part of its annual due diligence process. It has also built a social return on investment calculator to help potential and current investors estimate the social return their investment will generate. It is possible to refine the calculation by term, geographic region (any state or 7 international regions), and sector (housing, microlending, small business, or community development).

“We believe lack of access to reliable third party information [about social and financial performance] is keeping a lot of people from investing in this space,” Berenbach said. Calvert Foundation’s investors presently tend to be high net worth individuals and unstaffed family foundations in which officers have a high degree of decision-making flexibility and can integrate their personal and financial decisions. Of these individuals, 18% have over 10% of their total assets in community development investments.

Said Berenbach, “For each of us, it’s going to take applying the same level of rigor and discipline to this kind of investment as we would to investments

without social objectives. The challenge is to keep the bar very, very high so that we can move more and more capital to the communities who desperately need it.”

## Boston Community Capital

Boston Community Capital (BCC) was founded in 1985, initially as a community development loan fund focused on financing affordable housing in inner-city neighborhoods. In 1992, in response to changes in the market and growing and changing demand for capital in the communities it serves, BCC formally committed itself to expanding its capacity to deliver a range of financial products and services aimed at “building healthy communities where low-income people live and work.”

## Calvert Foundation Community Investment Portfolio SROI Analysis 1996–2003

Sector	% Activity	Portfolio	Unit Impact
Domestic US	75%		
Houses Built/Rehabilitated	45%	\$59,737,500	4,116
Microenterprise	5%	\$6,637,500	2,259
- Jobs from Microenterprises			4,888
Small Businesses	25%	\$33,187,500	1,706
- Jobs from Sm. Businesses			6,923
Nonprofit/Coop	25%	\$33,187,500	465
<b>Subtotal</b>		<b>\$132,750,000</b>	
International	25%		
Microenterprise	85%	\$37,612,500	45,902
- Jobs from Microenterprises			62,926
Nonprofit/Coop	15%	\$6,637,500	3,873
<b>Subtotal</b>		<b>\$44,250,000</b>	
Total Global Portfolios	100%		
Houses Built/Rehabilitated	34%	\$59,737,500	4,116
Microenterprise	25%	\$44,250,000	48,162
- Jobs from Microenterprises			67,814
Small Businesses	19%	\$33,187,500	1,706
- Jobs from Sm. Businesses			6,923
Nonprofit/Coop	23%	\$39,825,000	4,338
<b>Total</b>		<b>\$177,000,000</b>	

### *“We want to be a first-rate CDVC fund, not a third-rate VC fund”*

—Elyse Cherry

BCC launched its venture capital initiative, Boston Community Venture Fund (BCVF), in 1995 in response to the fact that equity capital just wasn't available for inner city entrepreneurs. Said BCC's Elyse Cherry, “Inner city entrepreneurs didn't build businesses that required venture capital investment because it didn't exist. Why create a business model that requires venture investment if you know no one is out there who will fund it?” BCC now has two venture funds with 14 portfolio companies overall and \$21 million under management. Its geographic focus includes companies in the northeast that can deliver solid financial returns and social returns under a broad definition that includes three interrelated categories:

- **Job retention and creation**
- **Development of entrepreneurship** among traditionally underserved groups, primarily women and entrepreneurs of color
- **Environmentally beneficial** products or services

Since BCC's funds have a ten-year life, it is still early to know exactly what return investors will receive. “We do think that we will achieve about 11% overall,” said Cherry.

**Social return assessment.** BCC collects quarterly data from its portfolio companies to track social and financial returns. In addition to reporting these data to venture fund investors, BCC uses them to measure the portfolio's progress, highlight trends and issues, and offer measurement standards that can be replicated across the CDVC industry. To date, Boston Community Capital has:

- **Committed over \$100 million** to low-income communities through more than 300 loans. These loans have created and preserved more than 4500 homes for low-income individuals and families;

provided day care facilities for more than 1100 children; and helped strengthen more than 200 community organizations.

- **Invested nearly \$15 million** in businesses that create social and economic return. BCC's venture funds have generated over 1300 quality jobs and over \$30 million in wages and benefits for low-income workers. The companies in its venture portfolio all offer health insurance and other benefits, provide entry-level wages between \$8-25 per hour, and offer training and career advancement opportunities that help workers move up the economic ladder.

BCC's philosophy is to seek companies in which the social return emerges from the business model. “I don't want to come in and tell an entrepreneur how to create social impact as a condition of investment. I want the impact to emerge from the business model itself,” said Cherry. She described some investment opportunities to illustrate BCC's embedded social returns approach:

We were approached by a clothing company in southeastern Massachusetts that was creating jobs for low-income workers. During our due diligence process, we learned that management had been paying their employees minimum wage, and were complaining that everyone wanted to go work for McDonald's, which paid \$1 more... [I]n a similar circumstance, I, too, would choose to work at McDonald's. It's hard to justify investing in a company that I would never choose to work for. Or put another way, I don't want to support jobs that are low quality. Needless to say, we didn't invest.

On the other side of the equation, City Fresh Foods is a company run by two young African American entrepreneurs. The company provides heart-healthy Caribbean and Latin food to residents of low-income

## COMMUNITY INVESTING: PROFILES

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neighborhoods, primarily senior citizens and school children. The company had a strong reason for locating in a low-income community: that's where its customers are.

The neighborhood has suffered from disinvestment for almost 30 years, so we were able to negotiate a favorable lease with the City of Boston for a building that was in tax-title foreclosure. The company was eventually able to buy and rehab its building, which is now a community asset; and we were able to use our equity dollars to help the entrepreneurs build a kitchen that can produce several thousand meals a day. City Fresh repaid our investment in 2001 with an almost 17% annual rate of return. And last year, they made the Inc. Inner City 100.

Cherry stated that one of the great challenges when investing in smaller companies is how to exit. BCC has been working to establish a liquidity vehicle for community development venture capital (CDVC) investments, and has produced two resource papers on the topic. "A core part of our work, and a key issue for this field, is to figure out how to connect poor communities to capital markets. Developing an effective exit strategy for these investments will be critical to our ability to attract new capital to the CDVC market."

### **Pacific Community Ventures**

Founded in 1999, Pacific Community Ventures was built from the strengths of its co-founders, Bud Colligan and Penelope Douglas: strong business networks and the ability to tap into corporate, community and financing resources of their own. PCV is a nonprofit organization that acts as the managing member of two venture capital funds, and provides business advisory services to our pool of investees and potential investees. The two funds PCV manages are limited liability corporations providing financial returns to their investors.

Pacific Community Ventures has raised \$19 million for its two funds, and has committed \$5.7 million to 11 businesses. PCV has also advised 50 companies.

**Social Return Assessment.** Since the organization seeks both financial and social return, it has developed a rigorous method for measuring the social outcomes of these financial investments. PCV asks, "If our capital is working well, what's happening inside those companies that has a social change benefit? What's happening to the employees while they are on the job?" Its metrics focus not only on outputs that can be counted, but also on data actually correlated with wealth creation and economic stability for the targeted employee population. With annual surveys administered by a third-party consultancy, and quarterly updates administered internally, the organization tracks changes in four indicators:

- **Quality of jobs**
- **Marketable skills for employees**
- **Retention of those employees (as opposed to job creation)**
- **Employee wealth creation**

These benefits are often the result of active negotiations in return for the equity of the deal. The group focuses on how to influence outcomes for low-income employees. An example of this was that they created an individual development account (IDA) initiative that matches savings for portfolio company employees to help them build wealth to use toward major assets or education expenditures.

PCV's social performance results are published in an annual comprehensive assessment, available at its website. Cumulatively from 2000-2002, a total of 633 designated employees (those who reside in low-to-moderate income zip codes or were hired through a referral from a qualified community development organization). Average hourly wages in PCV's financed

## COMMUNITY INVESTING: PROFILES

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portfolio increased 16% from \$10.54 to \$12.19, so that by 2000 71% of financed companies paid average hourly wages above living wage of the region (San Francisco). PCV tracks benefits, training, wealth creation mechanisms and has developed a job quality index to facilitate informed investment selection and development.

Douglas affirmed Berenbach's point that accountability and transparency are essential. "It is a very important point that all of us rely on credible third party data" to increase the credibility of social performance assessments. However, noted Douglas, "we clearly don't have the tools... to give investors all that you need to easily be able to make decisions across an array of institutions like our own. As a field we need to have more accountability around this. That said, we don't want to become so uniform particularly in terms of the social return innovations that we stifle innovation."

Douglas' last word: "We absolutely need to produce transparency, tell you about our governance and financial returns to the extent we can, the history of the field and our fund. I see a case for grantmaking to increase the depth and breadth of how to measure impact and how we can value that impact."

## COMMUNITY INVESTING: CONCLUSION

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**The** community investing industry offers a range of investment options, from those offering virtually no-risk returns comparable to mainstream fixed income investments at optional 0 to 3% returns, to venture capital that offers potential returns ranging from an estimated 8 to 12% or more. It has facilitated the creation of thousands if not millions of jobs, and helped entrepreneurs globally rise from poverty. Its investors include pension funds, banks, insurance companies, and individuals of all income levels. Community investing offers a sustainable strategy for breaking the cycle of poverty that in many cases is more effective than grantmaking alone.

However, experienced practitioners believe the lack of credible, accessible information about both social and financial performance is a barrier to the involvement of greater numbers of investors. Practitioners need to hold themselves accountable for innovating, implementing and publishing approaches that establish the connection between their dollars and social value creation. Grantmakers must help this process by providing funds to support this R&D until a day when the market recognizes the inherent value it delivers.

# ADDITIONAL RESOURCES

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**This** is a partial list of resources to help you explore the various aspects of mission-related investing.

Overviews of the social capital markets and of mission-related investing:

## Publications

- Emerson, Jed, Tim Freundlich and Shari Berenbach, “The Investor’s Toolkit: Generating Multiple Returns Through a Unified Investment Strategy,” [www.blendedvalue.org](http://www.blendedvalue.org), Summer 2004.
- Emerson, Jed. “Where Money Meets Mission: Breaking Down the Firewall Between Foundation Investments and Programming,” *Stanford Social Innovation Review*, Summer 2003.

## Resources

- BlendedValue.org, [www.blendedvalue.org](http://www.blendedvalue.org). Papers and annotated bibliography that overview the social capital markets, including SRI, social enterprise, social venture capital, and strategic philanthropy.
- Social Investment Forum, [www.socialinvest.org](http://www.socialinvest.org), Socially Responsible Investing overview and resources.
- Shareholder Action Network [www.shareholderaction.org](http://www.shareholderaction.org), shareholder advocacy overview and resources.

## Foundations with active MRI strategies (not exhaustive)

- Calvert Foundation, [www.calvertfoundation.org](http://www.calvertfoundation.org)
- F.B. Heron Foundation, [www.fdncenter.org/grantmaker/fbheron](http://www.fdncenter.org/grantmaker/fbheron)
- Jessie Smith Noyes Foundation, [www.noyes.org](http://www.noyes.org)
- Rudolph Steiner Foundation, [www.rsfoundation.org](http://www.rsfoundation.org)
- VanCity Community Foundation, [www.vancity.com/Community/AboutUs/Subsidiaries/VanCityCommunityFoundation](http://www.vancity.com/Community/AboutUs/Subsidiaries/VanCityCommunityFoundation)

## Social Venture Capital

- Cleantech Venture Network [www.cleantechventure.com](http://www.cleantechventure.com)
- Community Development Venture Capital Association [www.cdvca.org](http://www.cdvca.org)
- Research Initiative on Social Enterprise (RISE) [www.riseproject.org](http://www.riseproject.org)
- Catherine Clark and Josie Taylor Gaillard, “RISE Capital Market Report: The Double Bottom Line Private Equity Landscape in 2002/2003,” RISE, 2003.

## Social Returns Assessment References

- Calvert Foundation, [www.calvertfoundation.org](http://www.calvertfoundation.org)
- REDF, [www.redf.org](http://www.redf.org)

## Service Providers

- AtKisson Inc., [www.atkisson.com](http://www.atkisson.com)
- Balanced Scorecard Collaborative, [www.bscol.com](http://www.bscol.com)
- SVT Consulting, [www.svtconsulting.com](http://www.svtconsulting.com)

## Publications

- Epstein, Mark and Bill Birchard, “Counting what counts: turning corporate accountability to competitive advantage.” Perseus Books: Reading, Massachusetts, 1999.
- Epstein, Mark, “Measuring corporate environmental performance: best practices for costing and managing an effective environmental strategy.” McGraw-Hill: New York, 1996.
- Clark, Catherine, William Rosenzweig, David Long, Sara Olsen, and The Rockefeller Foundation, “Double Bottom Line Methods Catalog.” The Rockefeller Foundation, 2004.
- “SROI Methodology Overview,” Roberts Enterprise Development Fund (now REDF), 2001.

## ADDITIONAL RESOURCES

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- Lingane, Alison and Sara Olsen, “Guidelines for Social Return on Investment,” California Management Review, May 2004.

### Information about PRIs

- The Foundation Center, [www.fdncenter.org](http://www.fdncenter.org)
- Brody Weiser Burns, [www.brodyweiser.com](http://www.brodyweiser.com)
- Investors’ Circle Foundation, [www.investorscircle.net](http://www.investorscircle.net)

### Resources for Creating Proxy Voting Guidelines

- Institutional Shareholder Services, [www.issproxy.com](http://www.issproxy.com)
- Michael Jantzi Research Association, Inc., [www.mjra-jsi.com](http://www.mjra-jsi.com)
- Shareholder Association for Research and Education, [www.share.ca](http://www.share.ca)
- As You Sow Foundation, [www.asyousow.org](http://www.asyousow.org)
- Rockefeller Philanthropic Advisors, [www.rockpa.org](http://www.rockpa.org)

### Institutions that Post Their Proxy Votes and/or Guidelines Online

- California Public Employees’ Retirement System, [www.calpers.ca.gov](http://www.calpers.ca.gov)
- Calvert, [www.calvertgroup.com](http://www.calvertgroup.com)
- Domini Social Investments, [www.domini.com](http://www.domini.com)
- Ethical Funds, [www.ethicalfunds.com](http://www.ethicalfunds.com)
- General Board of Pension and Health Benefits of The United Methodist Church, [www.gbophb.org/retire.html](http://www.gbophb.org/retire.html)
- Meritas Mutual Funds, [www.meritas.ca](http://www.meritas.ca)
- MMA Praxis, [www.mmapraxis.com](http://www.mmapraxis.com)
- Ontario Teachers Pension Plan, [www.otpp.com](http://www.otpp.com)
- Pax World Funds, [www.paxfund.com](http://www.paxfund.com)
- University of Wisconsin, [www.wisc.edu](http://www.wisc.edu)
- Walden Asset Management, [www.waldenassetmgmt.com](http://www.waldenassetmgmt.com)