FUTURE MATTERS | On the Brink of New Promise
THE FUTURE OF U.S. COMMUNITY FOUNDATIONS

SPRING 2007

Reframing Endowment as a Tool for Community Leadership:

How Social Investing Could Change How Community Foundations Think About Their Financial Assets

Community foundations *are* about money. It is one of their defining features.

When we wrote about "a shift from managing financial assets to long-term leadership" in *On the Brink of New Promise*, we were dismayed to hear some people mistake that as a complete repudiation of the importance of endowment in community philanthropy. Like in the New Year's trend lists, community leadership was "in;" asset development was "out."

It wasn't what we intended. Community leadership and endowment building aren't mutually exclusive. The permanence that an endowment represents is a key part of what makes a community foundation effective. More than ever before, the endowment itself can be a powerful vehicle for community leadership. Applications of this endowed capital—beyond simply good grantmaking—have the potential to facilitate creative community leadership with long-term returns for the community and the foundation.

WHAT ARE FUTURE MATTERS?

On the Brink of New Promise: The Future of U.S. Community Foundations explored the changing context around community philanthropy and what it might mean for the future of community foundations. But as the context for the field continues to shift, Blueprint Research & Design, Inc. and the Monitor Institute are developing quick reports (*Future Matters*) to expand on the original report and discuss ongoing and emerging issues and trends that may matter to the future of community philanthropy.

Please write us at info@communityphilanthropy.org if you have thoughts or questions about this report, or to tell us what else you would like to see in upcoming *Future Matters*.

A community foundation's contributions to its region should be more than just grants, more than just convening, and more than just leadership—it should be all of these things, focused on a long-term vision of a better place. In pursuing such visions, community foundations are increasingly attuned to the depth and breadth of resources at their disposal—most notably in the opportunities they have to apply their endowed capital to the pursuit of their overall mission.

Investing capital in line with purpose is known by many names. Some refer to it as social investing; others call it aligned investing, double and triple bottom line investing, community investing, socially responsible investing, or mission and program related investing. All of these terms are correct. Some are more inclusive than others and some are actually references to specific tactical applications of capital. In general, social investing refers to the ways that an organization or individual can make investments that produce both social and financial benefits. In organized philanthropy, these strategies have a particular resonance as they provide new opportunities to produce social benefit while still creating new financial capital to be used in the future. Social investing offers an opportunity to create social change, while also building a foundation's endowment.

Traditionally, foundations created a clear firewall between the way they managed their financial investments and the way they used programmatic grant funds. As Jed Emerson, a senior fellow at Generation Investment Management explained, "Historically, foundations have maintained this impermeable wall between investing and programming…. [Five] percent of capital returns is assigned in pursuit of 100 percent of the institution's larger social mission, while 95 percent of capital assets are managed in pursuit of increasing financial value, with zero percent consideration for the institution's social mission."[1]

Social investing has begun to break down those barriers. Over the last decade, a few private foundations and a handful of community foundations, including the Cleveland Foundation, the Rhode Island Foundation, the Kalamazoo Community Foundation, the Boston Foundation, and the Vermont Community Foundation, have begun to experiment with investing a portion of their endowments to see if they can produce social change while also continuing to make financial returns that grow foundation assets over the long-term. They and others have pioneered new approaches beneath the rubric of social investing including: socially-responsible investing and screening, shareholder activism and proxy voting, and program related investment and mission investing.

This *Future Matters* serves as a primer for community foundations, unpacking these different elements of social investment and exploring what they might mean for the future of community philanthropy.

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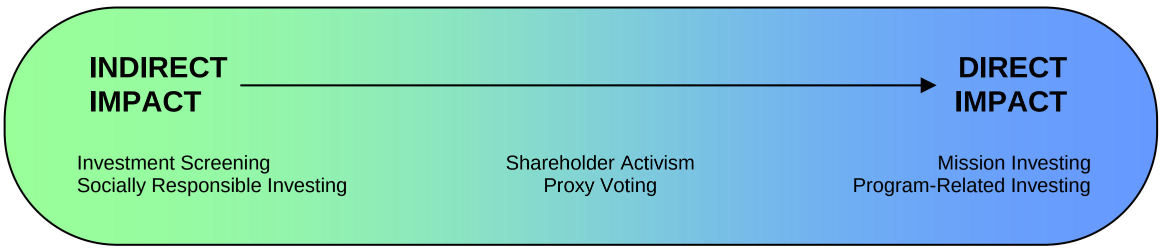
[1] Jed Emerson, "Where Money Meets Mission: Breaking Down the Firewall Between Foundation Investments and Programming," *Stanford Social Innovation Review*, Summer 2003.

A Spectrum of Tools for Social Investing

A recent study by FSG Social Impact Advisors found more than 90 foundations doing social investing in one form or another. And it is not just the big foundations. Almost a third of the foundations doing social investment that participated in the study had assets totaling less than $50 million, and small foundations accounted for almost 45 percent of all new social investment dollars in 2005. The study identified two dozen community foundations engaged in some form of social investing.[2]

To understand exactly what these funders are doing, it is helpful to think about the various approaches to social investing along a continuum of the level of direct community impact they can create.



At one end is socially responsible investing (SRI)—the use of qualitative screens to either filter out certain investments (like tobacco) or "filter in" others (like clean energy). These types of screens require only limited action from a foundation: the decision to select socially responsible mutual funds or investment managers. The approach can help ensure that a foundation's assets are invested in sync with, or at least not contrary to, its larger mission and values. But the small scale of any one foundation's resources relative to the larger financial marketplace limits the influence that a funder can have on corporate behavior through socially responsible investment choices.

Toward the middle of the spectrum is shareholder activism and proxy voting. This approach is centered on the belief that if a person or organization is a shareholder in a corporation, there is greater leverage to push that company to change. Shareholder activists use their power as shareholders to advocate their positions to the management of a company and to introduce proxy measures to adjust corporate practices. Examples include successful campaigns to get recycled products on the shelves of major office supply stores like Staples or Office Depot and to remove virgin timber from outlets of major home/hardware stores like Home Depot. These proxy voting efforts can produce important changes in corporate behavior, but they often have relatively little direct impact on local communities.

Finally, at the far end of the spectrum are program and mission related investing. These approaches include various tactics for directly investing endowment funds into enterprises related to the foundation's goals. Good examples include the creation of loan

[2] Sarah Cooch and Mark Kramer, *Compounding Impact: Mission Investing by US Foundations*, FSG Social Impact Advisors, 2007.

funds to refurbish downtown areas, real estate deals that benefit communities, investments in local companies that provide jobs and economic development in an area, and partnerships with land trusts to secure easements or conserve open space. These efforts often have a clear, targeted social or environmental impact on local communities and businesses.

To give a richer flavor of these approaches, let's examine each one in greater detail:

Socially-Responsible Investing and Screening
Socially-responsible investing looks at social, environmental, workplace, and governance performance to ensure that a foundation is investing in public securities that are not creating problems that run counter to its mission and goals. Traditionally, most foundations have operated on the premise that the goal of a foundation's investment management is to maximize returns to provide more resources for foundation programs and grantmaking. According to a study conducted by *The Chronicle of Philanthropy* in 2006, only one out of the 50 largest foundations in the United States—the Gordon and Betty Moore Foundation—reported actively screening its investments to explicitly exclude companies that directly conflict with the foundation's mission, and less than a third used screens of any sort (primarily simple screens that filter out companies involved in tobacco).[3]

Yet a number of other foundations have moved to ensure that their investment portfolios are more reflective of the values and mission of the organization. Since early pioneers like Domini Social Investments and the Calvert Funds first launched SRI mutual funds in the 1980s, the field has grown dramatically. According to a 2005 report by the Social Investment Forum, SRI assets have risen more than 250 percent since 1995, from $639 billion to over $2.25 trillion in 2005. About one out of every ten dollars under professional management in the U.S. is now involved in socially responsible investing.[4] And much of the evidence has refuted early contentions that social screening would automatically result in underperformance. A listing of the screens that various SRI mutual funds use and their past financial performance can be found at the Social Investment Forum website at www.socialinvest.org/Areas/SRIGuide/Screening.htm.

Organizations like the Jesse Smith Noyes Foundation in New York have developed institutional policies that use investment screens to "reduce the dissonance between philanthropic mission and endowment management." The foundation uses negative screens (that exclude stocks of companies that have policies and practices that run counter to the foundation's mission and values) and positive screens (that actively invest in companies with responsible business practices or which offer socially and environmentally beneficial products and services) to guide its investments related to environmental justice, sustainable agriculture, reproductive health and rights, and social justice. According to Noyes Foundation president Victor De Luca, "It makes no sense to use 5 percent of your assets to try to promote something, while the other 95 percent might be doing something totally contrary. We try to use 100 percent of our assets to promote

[3] *The Chronicle of Philanthropy,* "Stock-Investment Policies at the 50 Wealthiest Private Foundations," May 4, 2006.
[4] Social Investment Forum, *2005 Report on Socially Responsible Investing Trends in the United States*, 2005.

our values."[5] To learn more about the Noyes Foundation investment policy, visit www.noyes.org/investpol.html.

Applying screens to a community foundation's endowment can be more complicated. The Vermont Community Foundation (www.vermontcf.org) investment committee explored the use of screened funds, but ultimately found that there were few screens that were appropriate for *all* members of the community it serves. So it has kept its primary corpus under mainstream management and has launched a separate "socially responsive investment pool" as an option for new donors and established funds that are interested in putting their money into socially-responsible investments. The foundation believes that the new socially responsive investing option will be an important value-added service that it can offer its donors in the coming years.

Shareholder activism and proxy voting

Shareholder activism and *proxy voting* represent another key way that foundations can reduce the dissonance between their missions and their financial investments. While much of the Vermont Community Foundation endowment remains invested in more conventional holdings, the foundation has taken advantage of its position as a shareholder in different mainstream companies to press them to be more responsive to communities' environmental and social needs. The foundation began to research its holdings and developed a set of proxy "guidances" to help advise its money managers about how to exercise their proxy votes. And in January 2007, the VCF became the first community foundation in the country to co-sponsor a proxy resolution, co-filing an initiative to encourage racial and gender diversity at Bed, Bath, and Beyond.

In this respect, the VCF is following a lead established in the community foundation world by the Boston Foundation, one of the philanthropic pioneers of shareholder activism and proxy voting. Coming out of efforts in the 1980s to divest itself of companies with ties to South Africa and later, tobacco, in the early 2000s the foundation recognized that proxy voting might actually be a more powerful tool than divestiture, because divestment relinquished the power to persuade a company to change its practices. Since 2002, the foundation has had a policy of voting its shareholder proxies in accordance with the foundation's mission and values, particularly on issues related to the environment, community well-being and citizenship, diversity and equity, and good corporate governance. The effort requires the review of hundreds of proxy requests each year, so to minimize the workload for its staff, the foundation contracts with Institutional Shareholder Services (ISS), a professional proxy voting firm, to track proxy choices from the 1,400 companies in which it owns stock. The Boston Foundation proxy voting policy can be found on its website at www.tbf.org/About/about-L2.asp?id=189.

Program Related Investments and Mission Investing

The emergence of social investing has also helped surface a number of new ways to deploy a Foundation's endowment in direct support of its mission. Where the foundation once had just one primary tool—the grant—today it includes a range of program and mission related investments that produce both social and financial benefit, ranging from

[5] Emerson, "Where Money Meets Mission."

loans and deposits to fixed income securities and private equity investments. Unlike grants, these tools allow a foundation to recover and recycle funds for future use.

Program Related Investments (PRIs) are debt or equity investments made for charitable purposes at below market terms. Unlike grants, PRI funds can be recovered by a foundation and recycled for subsequent charitable investments. Legally, they are considered charitable distributions and count against a foundation's payout requirement. They are required to have the primary purpose of forwarding the foundation's charitable goals, and the production of income cannot be a "significant purpose" of the investment.

Contrary to popular conception, PRI's are not just a single asset class; foundations can issue PRIs in the form of loans, loan guarantees, recoverable grants, and equity investments. But the large majority of PRIs take the form of low-interest or no-interest loans to nonprofits. In general, they are used to address gap financing and cash flow issues and to leverage additional capital from conventional sources by reducing real or perceived risk. Receiving even a small, below-market return on a program related investment means that the foundation has that much more money to use for future programming.

A Selection of Key Readings about Social Investing

- The **PRI Makers website** has a wide range of resources available at *www.primakers.net*.
- ***Compounding Impact: Mission Investing by US Foundations***, FSG Social Impact Advisors, 2007. www.fsg-impact.org/app/content/ideas/item/485.
- ***New Frontiers in Mission Related Investing***, F.B. Heron Foundation, 2004. www.fbheron.org/viewbook_frontiers.pdf.
- "**Where Money Meets Mission: Breaking Down the Firewall Between Foundation Investments and Programming**," Jed Emerson, *Stanford Social Innovation Review*, 2003. http://www.community-wealth.org/_pdfs/articles-publications/pris/article-emerson.pdf.
- **Program-Related Investing: Skills & Strategies for New PRI Funders**, Grantcraft, 2006. www.grantcraft.org/index.cfm?fuseaction=Page.viewPage&pageID=821.
- **Unlocking the Power of the Proxy**, As You Sow Foundation and Rockefeller Philanthropy Advisors, 2004. www.asyousow.org/publications/powerproxy.pdf.
- ***2005 Report on Socially Responsible Investing Trends in the United States***, Social Investment Forum, 2005. http://www.socialinvest.org/areas/research/trends/sri_trends_report_2005.pdf.

A small number of community foundations have been making program related investments since the 1970s, when the Cleveland Foundation board made one of the first PRIs by a community foundation to buy and restore several historical theaters in downtown Cleveland that were slated to be demolished.

More recently, foundations like the Kalamazoo Community Foundation have used low cost loans and loan guarantees to leverage economic development and redevelopment in downtown areas. In Kalamazoo, the community foundation has made a number of different PRIs, providing one local nonprofit real estate developer with a $784,000 loan to purchase property in the central business district for resale and redevelopment and making the County economic development entity a $2 million PRI to complete the financing of an Innovation Center in a local business/research park.

In Providence, the Rhode Island Foundation (RIF) has also made several significant PRIs. It provided investment to launch the Downcity Partnership, which included a $9 million revolving loan fund to support local retail, build housing, and revitalize the downtown area of Providence. The foundation also made a PRI in 2000 to purchase the out-of-state ownership of a for-profit HMO to ensure the health organization continued service to low income Rhode Island residents. After the purchase, the foundation converted the stock into a long-term, low-interest loan to the now nonprofit Neighborhood Health Plan of Rhode Island.

Mission Related Investments (MRIs) include a range of different opportunities that provide market rate returns but also advance a foundation's mission, including:

- Insured deposits in community development credit unions and community development banks across the U.S. (it is possible to deposit up to $100,000 in a credit union and up to $20 million in a community development bank with full federal deposit insurance);
- Fixed-income securities and bonds (for example, bonds from a city's redevelopment agency to facilitate the redevelopment of local blighted areas); and
- Equity (or "equity-like") investments in private companies or venture capital funds that seek a "double bottom line" return that provides both social and financial benefit (like the Yucaipa Corporate Initiatives Fund, a $577 million private equity fund that invests in corporations that locate in, relocate to, or expand their operations in underserved rural and urban communities throughout the United States).[6]

These types of mission related investments become even more interesting when considered through a community philanthropy lens. While it can be difficult to find a large pipeline of socially responsible investments, *any* investment in businesses in the target community will promote a community foundation's mission by creating new jobs and economic development. Program and mission related investments targeted to a specific geography in this way are often termed *community investing*.

This locally-focused approach has also been pioneered by private foundations like the Abell Foundation, a geographically-focused funder committed to improving the quality of life in Baltimore. Abell set aside about 15 percent of its endowment portfolio for venture investments in small- and medium-sized enterprises that are starting up or growing in Baltimore. According to Abell president Robert Embry, "Our mission is primarily to improve the situation in Baltimore. So to the extent that we create jobs and establish corporate headquarters in Baltimore, we are benefiting the city, and those in it, who are disproportionately poor."[7]

A similar philosophy has guided the investment approach of the Vermont Community Foundation. The VCF has placed 5 percent of its endowment directly in service of its

[6] Recoverable grants from foundations function much like equity investments for nonprofits. They are made to projects that are expected to be financially viable, but where high risk means that debt may take a long time to recover, or may not be recoverable at all, although repayment and return on investment is expected.
[7] Emerson, "Where Money Meets Mission."

Vermont-focused mission. These Vermont Investments, which will total about $6 million by the end of 2007, include community and housing loans, deposits with local banks and credit unions, loans to community development financial institutions, and venture capital investments in early-stage Vermont business ventures. Rather than acting as a direct lender and investor itself, the VCF has outsourced due diligence on potential MRI investments to intermediary organizations. It is too early to tell about the results of the venture investments, but returns from the other state-focused investments appear to be on track. In Michigan, the Kalamazoo Community Foundation has taken a similar approach, becoming a limited partner in three funds making investments in businesses with a significant presence in the community.

All of these approaches appear to provide returns that closely track expectations. The F.B. Heron Foundation, a social investing pioneer with one of the longest track records in the field, has come close to meeting or exceeding its performance benchmarks for each asset class in its mission related portfolio (PRIs, mission related deposits, fixed income securities, and equity investments). Overall, the foundation's total return of 21.07% in 2003 placed it at or above the median for endowments in a number of investment surveys.[8] The 2007 FSG study found that the limited data they could find on rates of return also seemed to track closely with expectations.[9]

GETTING STARTED WITH SOCIAL INVESTING

At this point, only a small contingent of foundations have begun to dip their toes in the social investing water. And while a number of community foundations have expressed interest in various aspects of the approach, almost none have yet taken the plunge. There are a number of reasons for this reticence, some real, and others less well-founded:

- The perception that it takes a great deal of time and expertise to research social investment options.
- Fear of the additional risk from social investments and concerns about reduced financial returns.
- Concerns about the availability of a robust pipeline of appropriate local businesses and other social investments.
- The challenge of socially responsible screens that are acceptable for the *entire* community.

To allay these types of concerns, there are a number of easy first steps a community philanthropy organization can take to get their feet wet in social investing:

- Do an analysis of the social, environmental, and governance performance of your current investment portfolio using ratings produced by an organization like Kinder, Lydenberg, Domini Research & Analytics (KLD) (www.kld.com).

[8] F.B. Heron Foundation, *New Frontiers in Mission-Related Investing*, 2004.
[9] Cooch and Kramer, *Compounding Impact*.

- Check out the website of the Social Investment Forum (www.socialinvest.org) to learn more about socially responsible investing, or contact one or more of the SRI mutual funds identified on their site directly.
- Learn more about proxy voting and shareholder activism at the As You Sow Foundation website (www.asyousow.org) or Rockefeller Philanthropy Advisors (www.rockpa.org).
- Learn more about social investing or join a community of others interested in the subject at one of several new websites:
    - PRI Makers, the association of grantmakers (both small and large) who use program-related and other investments to accomplish their philanthropic goals (www.primakers.org). PRI Makers provides a range of introductory resources on the site, as well as information about upcoming workshops and trainings.
    - Xigi.net, which features a forum for dialogue among social investors and intermediaries and a database that highlights deal sizing, terms, and other information.
    - The MIX Market (www.mixmarket.org), which provides basic information and performance data about microfinance institutions worldwide.
    - The Community Investing Database (www.communityinvestingcenterdb.org), which helps investors to identify mission related investing opportunities offered by community development financial institutions.
- Create a socially-responsible investment pool at your foundation that gives your donors and funds the option of investing in new ways. Providing local individuals the option of placing the corpus of their donor-advised funds in socially-responsible investments could become an important point of differentiation for community foundations.
- Try a small program related investment to help the foundation better understand the PRI process. Interested funders can start getting ready by reading the Grantcraft guide, *Program-Related Investing: Skills & Strategies for New PRI Funders* (www.grantcraft.org).
- Make an insured deposit to a local community development credit union or community development bank as a way to try mission related investing without financial risk.
- Contact an experienced intermediary or consultant like GPS Capital Partners (www.gpscapitalpartners.com), the Calvert Foundation (www.calvertfoundation.org), or Access Capital (www.accesscapitalfunds.com) that works with foundations to identify mission related investment opportunities.
- Consider ways to make it easy for individual donors to learn about and engage in social investment. Make information about social investing available to local

philanthropists, and work with intermediaries or consultants to develop a vehicle for helping local donors experiment with social and community investing.

LEVERAGING LEADERSHIP WITH ASSETS

Despite a misperception that endowment building and community leadership are somehow incompatible within a community foundation, the real power of endowments to produce community change has never been greater. A foundation's corpus can be a real tool for leadership, not just for making money. The emergence of social investing has opened up a range of new avenues for community foundations to use all of their assets to improve their communities.

These new opportunities could have a profound effect on the future of community philanthropy. In 2004, the 700 community foundations in the United States made almost $3 billion in grants. This represents just 7.5 percent of their total assets. Just imagine what community foundations could do if they increased their financial investments in their communities by even a fraction.

The Future of Community Philanthropy
project is a joint effort of Blueprint Research & Design, Inc. and the Monitor Institute, funded by the C.S. Mott Foundation and the Ford Foundation. The project team includes Katherine Fulton and Gabriel Kasper of the Monitor Institute and Lucy Bernholz of Blueprint Research & Design.
This report was written by Mr. Kasper, in collaboration with Ms. Bernholz and Ms. Fulton. For more information about the project, visit www.communityphilanthropy.org.