

Foundations and social investment

*making money work harder
in order to achieve more*

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Foreword



The issue of social investment is an important one for grantmaking foundations. Informal discussions with other funders identified a need to summarise experience of social investment to date. The result is this report. The partners in this work – The Ashden Trust, Esmée Fairbairn Foundation, Tudor Trust and Venturesome (part of the Charities Aid Foundation) – are keen to encourage a rigorous debate on this topic.

There are a number of approaches open to foundations for engaging in their areas of interest. Grantmaking remains a vital tool, but there may be other ways in which foundations can successfully realise their aims. This report describes the principles and concepts behind social investment and uses real case studies – from both the UK and the US – to help shed light on how social investments have actually happened and worked in practice.

On behalf of all those involved in this discussion, we hope this report proves useful in helping trustees, staff and others as they grapple with these issues and proves to be a practical tool in helping work out the best approach for them.

Jeremy Hardie
Chairman, Esmée Fairbairn Foundation

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Margaret Bolton

1. Executive summary

Charitable grantmaking foundations work for the public benefit. They have a wide variety of purposes including addressing disadvantage, improving quality of life and protecting the environment. They strive to make best use of their resources. Social investment is a valuable tool for foundations which enables them to achieve more by making their money work harder.

What is social investment?

Typically, foundations invest for the maximum financial return in mainstream financial products. They then use the income for grantmaking to achieve their charitable purposes. Social investment challenges this model. It takes two main forms:

- **Programme related investment:** loans or equity purchases, funded from the foundation's income or capital, *with the primary aim of advancing the foundation's charitable purposes.*
- **Socially responsible investment:** loans, equity or fixed asset purchases, funded from the foundation's capital, *with the primary aim of producing income or appreciation in value* but with some weight given to social considerations in choosing which investments to make and/or how to manage them.

Socially responsible investment takes a variety of forms: positive and negative screening of investments and shareholder action. Where positive screens are used, investments are selected which also advance the foundation's charitable purposes. In this report this activity is called **investment plus**.

The issue for the FB Heron Foundation is not whether private philanthropy has done well but whether it can do better.

Luthur M Ragin, Jr *New Frontiers in Mission-Related Investing*, The FB Heron Foundation (2004)

Why do it?

Social investment makes money work harder, it:

- enables foundations to recycle funds and helps build management capacity in voluntary organisations (*programme related investment*);
- enables foundations to invest their capital in ways that at worst do not erode and at best support the common good (*socially responsible investment*);
- challenges the received wisdom that investment and grantmaking funds have to be kept in separate silos and so enables foundations to use part of their capital to achieve their charitable purposes (*investment plus*);
- helps voluntary organisations access capital (*programme related investment*) - it is generally acknowledged that difficulties accessing capital are hampering voluntary organisations in their efforts to develop new income generating services.

The first step is to recognise that foundations are not simply vehicles for distribution of charitable gifts, but rather investors in value creation... The key is for foundation leaders to open a discussion – particularly if the topic of program related investing has been taboo – fostering recognition that grants are only one tool among many for advancing mission.

Jed Emerson from *The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation* (2004)

The aim of this report

Relatively few foundations in either the UK or the US have developed significant or sustained social investment initiatives. Nonetheless interest in social investment is growing amongst foundations on both sides of the Atlantic. This report aims to support and further stimulate interest by providing foundations with information about social investment and its relevance to their goals and strategies. It reflects on social investment approaches, their pros and cons and critical success factors.

Key findings

In considering the approaches outlined above, foundations should bear in mind the following key findings which emerge from the UK examples and US case studies featured in sections 4 and 5:

■ Small and medium are beautiful

It is often assumed that only large foundations have the resources to engage in social investment. However, many of the foundations experimenting successfully with social investment are small or medium sized foundations.

■ Stimulate trustee interest and support

All the US foundations developing innovative approaches have strong advocates for social investment on their boards.

■ Experiment by allocating a small percentage of funds to social investment

Most foundations engaged in *programme related investment* and/or *investment plus* have allocated only a small proportion of their funds to these approaches.

■ Vary approaches to risk

The case studies in section 5 illustrate that different types of *programme related investment* and *investment plus* carry different levels of risk and foundations can choose a level of risk exposure with which they are comfortable.

■ Use/support intermediaries

Many of the foundations which have developed successful *programme related investment* and *investment plus* strategies have worked with or through specialist intermediaries, for example Venturesome in the UK or the Calvert Social Investment Foundation in the US.

■ Acknowledge programme related investment as a tool in the funding armory

Programme related investment is now generally regarded in the US as a valuable 'supplementary tool' to be used alongside grants in appropriate circumstances. In some successful initiatives *programme related investment* forms part of a larger package that includes grant funding and advice and support with capacity building for the voluntary organisation.

■ Acknowledge the opportunities for investment plus

Generally foundations have less experience of investment plus than of programme related investment. However, there are likely to be some high quality investment plus opportunities in certain fields, for example environmental protection and conservation.

■ Develop new investment plus products

The work of the Heron Foundation in the US shows how foundations can develop new *investment plus* products.

■ Tie investment screening policies to charitable purposes

Those foundations successfully screening their investments generally have policies tied closely to their charitable purposes. For example, a foundation concerned with protecting the environment with a screening policy focused on environmental issues has the necessary expertise to apply its policy judiciously.

This report attempts in part to survey US experience. If that experience is anything to go by, it is likely that over the medium term an increasing number of UK foundations will make social investments and that such investments, grants and fees for services related to social investment programmes will enable the development and growth of specialist intermediaries.

The likely picture over the longer term is of a market gaining maturity in which *programme related investments* tend to be more complex, diverse and provided in support of more speculative social ventures. And a market in which an increasing number of foundations are engaged in socially responsible investment including *investment plus*. Over time these developments will make a significant contribution by increasing the limited resources available for projects run by voluntary organisations or other social businesses - projects which break the mould of existing products or services or which meet needs previously ill catered for or ignored.

2. Introduction

Charitable grantmaking foundations work for the public benefit. They have a wide variety of purposes including addressing disadvantage, improving quality of life and protecting the environment. They strive to make best use of their resources.

Social investment challenges many of our notions about charities and charitable investment. Conventional wisdom is that charities are required to keep their money in two different silos: it is for investment or grantmaking. Further, it is often assumed that trustees should maximise their returns by investing only in mainstream financial products without regard to their match or mismatch with the foundations charitable purposes. Over the last thirty years or so some practitioners in the UK and US have challenged this orthodoxy by making social investments.

What is social investment?

Some foundations in the UK and US now engage in a wide spectrum of social investment activity defined as investment¹ which generates a social² as well as a financial return³. This investment takes two main forms.

- Programme related investment: loans or equity⁴ purchases, provided from the foundation's income or capital⁵, with **the primary aim of advancing the foundation's charitable purposes**.
- Socially responsible investment: loans, equity or fixed-asset purchase, funded from the foundation's capital, with **the primary aim of producing income or appreciation in value** but with some weight given to social desirability in choosing which investments to make and/or how to manage them.

Socially responsible investment can take a variety of forms:

- negative screening – to avoid socially harmful ways of getting a good return an ethical investment policy is developed and companies which do not match up are excluded;
- positive screening – socially beneficial ways of getting a good return are sought out and investment is made for example, in companies with responsible business practices or which offer beneficial goods or services;
- shareholder action – investors encourage more responsible business practice by voting their proxies and/or making direct contact with companies.

A foundation may use a wide range of positive or negative screens in choosing its investments. Sometimes these screens will be directly aligned with the foundation's charitable purposes, in other cases not - they may for example, be concerned with corporate governance or a wide range of broader social issues. Where positive screens are used to help the foundation select investments which also help it advance its charitable purposes, this practice is called in this report *investment plus* (see the boxes opposite and on page 8 for respectively a diagrammatic representation of the field and a discussion of definitions).

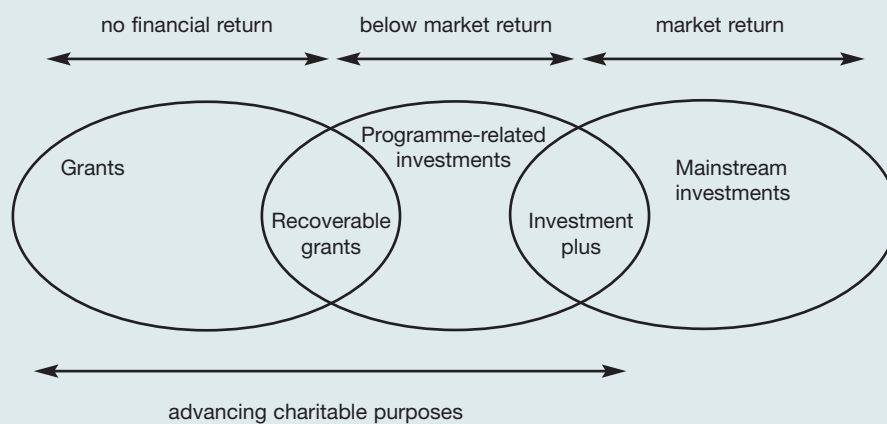
1– Growing interest in venture philanthropy means that the term investment is now used in some circles to cover grants as well as loans or equity. In this paper the term investment is used exclusively to describe loans or equity investments.

2– Social is used throughout this paper to cover both social and environmental.

3– This definition is derived from J Emerson's in *The Blended Value Map*: 'investing in organisations that create social and financial value'.

4– Or quasi equity. Quasi equity is explained in a box on page 19. Loan guarantees are also a form of social investment which is growing in importance.

5– Guidance from the Charity Commission clarifies that foundations in the UK can make programme related investments either from expendable endowment or from income.



Notes

1. Mainstream investments may be positively or negatively screened or investors may engage in shareholder action including proxy voting in relation to them. This means that some forms of mainstream investment will have social returns and will count as social investments.
2. *Investment plus* is placed in the intersection between *programme related investments* and mainstream investments because like *programme related investment* it enables a foundation to advance its charitable purposes and like a mainstream investment it generates a market return.
3. Some *programme related investments*, although the primary motivation for making them is not financial, produce a healthy return comparable to market rates.

Certain legal principles affect which types of social investment a charitable foundation can make, and under what conditions. The Charity Commission has published guidelines on *programme related investment*⁶. This explains that *programme related investment* is not investment 'in the conventional sense of a financial investment', therefore the usual charity law principle that return should be maximised does not apply. The Charity Commission's general guidance on investment contains a section on socially responsible investment. This says that 'trustees may well consider that the adoption of a particular ethical investment policy does not detract from the objective of obtaining the best direct financial return for investment'⁷. It goes on to explain the limited circumstances in which trustees may adopt a policy which has an adverse impact on return (see the box at the end of this section)⁸.

6 – The Charity Commission (2002) *Useful Guidelines on Social Investment*

7 – The Strategy Unit report *Private Action, Public Benefit* provided the following gloss in 2002: 'Since ethical funds, on average, produce an economic return that is very similar to non-ethical ones, this means that trustees are free to choose from the wide range of ethical funds available'.

8 – The Charity Commission (December 2004) *CC14: Investment of Charitable Funds: Basic Principles*

US definitions

The term ‘program related investment’ was created by the US Congress in the Tax Act of 1969. This legislation defines it as any investment by a foundation that meets the following three tests:

1. Its primary purpose is to further the objectives of the foundation.
2. The production of income or the appreciation of property can not be a significant purpose.
3. It is not used to lobby or support lobbying.

Another term used in the US but not used in the discussion in this report is ‘mission related investment’. Some foundations use it as a blanket term to cover both programme related investment and investment plus as defined in this report (for example, the Heron Foundation). Others use the term ‘mission related investment’ to describe the range of activity described here as socially responsible investment (for example, the Jessie Smith Noyes Foundation). Some have adopted other terms to describe what is defined here as investment plus. For example, the McArthur Foundation describes it as ‘investment in support of programme’. This illustrates that terminology is still evolving and definitions are not as yet agreed.

Why do it?

There are a number of reasons why foundations might choose to consider social investment:

A desire to achieve the maximum impact with limited resources

Social investment helps foundations increase their impact. Funds used for programme related investment are recycled thereby generating social returns many times over. Investment plus enables foundations to use a greater proportion of their total resources to advance their charitable purposes.

...for most foundations...95 per cent of capital assets are managed in pursuit of increasing financial value, with zero per cent consideration for the institution's social mission...

However, shouldn't a foundation's investment strategy seek to maximise not only financial value, but social and environmental value as well?

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

An interest in building stronger voluntary organisations⁹

Provision of loans and equity often enables voluntary organisations to acquire an asset which can help secure medium to longer-term sustainability. It is also believed that the process of securing and managing a loan or equity generally demands that organisations develop their financial and management capacity.

Capacity building is one of our primary goals. And we've created a [PRI] programme that develops capacity within individuals and organisations. It helps to teach people how to use credit – how to think differently about financing their organisations.

Donald S. Perkins, a Ford Foundation trustee, in *Investing for Social Gain: Reflections on Two Decades of Program Related Investment*, Ford Foundation (1991)

⁹ – Throughout this report the term voluntary organisation is used to refer to voluntary and community organisations including those with charitable status.

A desire to help good organisations grow and develop

There is increasing awareness that some voluntary organisations and other social businesses will only be able to grow and develop by accessing debt or equity from sympathetic providers. This is a realistic prospect for some because their services will generate a relatively secure income enabling repayment of the debt or a return on equity.

A desire to make strategic investments which build social markets

Some foundations characterise themselves as strategic funders – they may, for example, seek to develop a particular sub sector, such as organisations dealing with substance abuse or a particular type of provision, such as housing. Over the longer term this is likely to be facilitated by providing loans and equity alongside grants for appropriate projects.

An increased emphasis on accountability and transparency

All charities, including foundations, are likely to come under increased pressure to demonstrate that their practices, including their investment policy, reinforce rather than undermine their mission. This pressure will in part be stimulated by a requirement for larger charities to make public their investment strategy including their policy on ethical investment¹⁰.

A growing awareness of the link between good corporate policy and profitability

There is growing awareness that bad corporate practice on issues like environmental protection or child labour can have a significant adverse impact on profitability over the longer term.

...there is an increasingly held view that companies which act in a socially responsible way are more likely to flourish and to deliver the best long term balance between risk and return.

Charity Commission, *CC14: Investment of Charitable Funds*, revised February 2003

Are foundations engaged?

There is comparatively little data about the extent to which foundations are engaged in social investment in either the UK or the US. A recent members survey conducted by the Association of Charitable Foundations (ACF) indicates that 20 plus of over 300 members have offered loan finance¹¹. In the US the Foundation Centre undertakes a periodic survey of programme related investment; their 2003 publication identified 255 foundation providers compared with over 61,000 foundations active in the US in that year¹². Only limited and often anecdotal evidence exists about foundation engagement in other forms of social investment in both countries.

Most foundations' knowledge and experience of social investment may as yet be underdeveloped but interest is growing. This is in part because a number of skilled practitioners on both sides of the Atlantic, held in high regard by their colleagues, are promoting social investment in its various forms. These practitioners include David Carrington and Geraldine Peacock in the UK¹³ and Jed Emerson and Luther Ragin, Jr in the US. Another important factor is US and UK government efforts to 'grow' the market. Both governments developed programmes aimed at encouraging investment in disadvantaged or underserved communities. The UK government has also sought to build the capacity and maintain the standing of voluntary organisations by encouraging social investment. (See Annex 1 for a survey of recent UK government initiatives.)

10 – It is proposed that the new Standard Information Return for charities with a turnover over £1 million should include this information.

11 – Information provided by ACF.

12 – The \$233 million used for this purpose was less than 1 per cent of the \$31 billion awarded in grants. *The PRI Directory: Charitable Loans and Other Program Related Investments* by Foundations (2003).

13 – Both were members of the UK Social Investment Task Force. Geraldine Peacock is Chair of the Charity Commission for England and Wales.

Charity Commission guidance on programme related investment

The Charity Commission's guidance on social investment explains that programme related investments can generate some financial return, although the primary motivation for making them is not financial but the actual furtherance of the charity's objects. This means that the normal rules on financial investments, for example in the Trustee Act 2000 do not apply. The guidance says that any charity that can give grants can provide support in other ways (eg by making loans, by purchasing or subscribing for shares, or by letting land and buildings) unless it is specifically prohibited in the charity's governing document. It also explains that charities can make programme related investments from any resources which are available for application for the charity's purposes. That means the charity's income (and reserves) and the charity's expendable endowment. The guidance also emphasises that grantmaking or service providing charities may support specialist intermediaries rather than developing significant loan programmes in house.

For more information see the Charity Commission's *Useful Guidelines on Social Investment* (2002).

Charity Commission guidance on investment

There are three circumstances in which trustees may adopt an ethical investment policy:

1. They may decide not to invest in businesses which conflict with the aims of the charity. For example, a charity with objects for the protection of the environment and wildlife may decide not to invest in businesses which pollute.
2. They may avoid investments that could hamper their work, either by making potential beneficiaries unwilling to be helped, or by alienating supporters. Here, trustees have to weigh the likely costs of lost support with the risk of financial underperformance.
3. They may make investment decisions on moral grounds (using positive or negative criteria, or a combination). In these cases, however, the trustees must be clear that their decisions 'will not place the charity at risk of significant financial detriment due to under performance by the preferred investments or by the exclusion from consideration of forms of investment to which the trustees are opposed'.

For more information see Charity Commission guidance *CC14: Investment of Charitable Funds: Basic Principles* (December 2004).

The aim of this report

This report aims to support and further stimulate interest by providing foundations with information about social investment and its relevance to their goals and strategies. It reflects on social investment approaches, their pros and cons and critical success factors. The report is based on desk research and interviews with both UK and US experts in the field (see Annex 2 for a list of interviewees).

3. Historical background and recent developments

Social investment is not new – it is an approach that is being remodelled to meet twenty first century needs.

Programme related investment

The history of programme related investment can be traced back to efforts by eighteenth and nineteenth century philanthropists in both the UK and US to develop affordable housing for those on low incomes and to provide those without other backing the capital necessary to set up in business. When the Ford and Taconic Foundations rediscovered programme related investment at the end of the 1960s they saw it as a means of providing much needed capital investment to black and minority owned businesses.

The first Ford Foundation programme related investment initiative

Ford's first programme related investment initiative in the late 1960's supported black and minority owned businesses. In the early days there were significant losses. This was an inevitable result of its approach; loans to individuals developing small businesses are notoriously risky – a large proportion of small businesses fold during their first year. The Foundation did not have expertise in the market areas in which individuals were developing businesses and it lacked sufficient knowledge of the individuals receiving loans or equity investment.

After the initiative was reviewed the emphasis was shifted to support for specialist intermediaries – organisations with expertise in providing loans and equity both to individuals and organisations – and to support for organisations which had an established relationship with the Foundation and whose needs and management capacities were well known to it. Many foundations have since adopted this dual approach to programme related investment.

A staff member of the Ford Foundation recalls: *We discovered quickly that we wouldn't be able to handle a lot of direct investments in ventures. So we turned to intermediaries, who can both administer loan funds and provide technical assistance and back-up support.* Ford continues to use intermediaries to deliver programme related investment (see case study 2 in section 5).

Ford and Taconic successfully pressed for statutory recognition of programme related investment in the 1969 Tax Act. This settled legal arguments about whether or not trustees could make such investments. Many experts regard this statutory recognition as key to the acceptance and development of programme related investment in the US and the subsequent development of community development finance. Partly as a result of foundation programme related investment (and more recently some investment plus) a strong network of specialist intermediaries providing community development finance has evolved in the US. These intermediaries are normally known as Community Development Finance Institutions (CDFIs).

In 2000 the UK Social Investment Task Force in its report to HM Treasury reflected on US experience and highlighted the pioneering efforts of a small number of UK foundations in supporting community development finance (see the next section for some examples). However, it identified a number of obstacles to wider foundation engagement. It referred to uncertainty as to when support for regeneration and employment creation could be charitable and when it was acceptable for charities to provide programme related investment.

The Charity Commission in response published guidance on regeneration and employment creation and on programme related investment¹⁴ clarifying charities' ability both to support employment creation projects and to provide loans and equity alongside grants. It suggested that foundations support community development finance by offering grants or loans to specialist intermediaries¹⁵.

In the US programme related investment, which traditionally financed community development finance, now supports a much wider range of causes for example, the arts and social services¹⁶. The buoyant stock market in the 1990s encouraged US foundations to offer such investments¹⁷. They count towards the 5 per cent annual foundation payout requirement and helped many foundations achieve the minimum payout at a time when the value of their assets was increasing dramatically¹⁸.

Socially responsible investment

The most commonly recognised form of socially responsible investment is negative screening. Negative screening, like programme related investment, has a long history. It can be traced back to early last century when religious institutions divested their portfolios of alcohol, gambling and tobacco stocks¹⁹. A number of foundations in the UK and US now engage in limited negative screening of investments. For example, some refuse to invest in arms companies or the tobacco industry.

Positive screening is much rarer²⁰ including the use of positive screens to select investments which advance the foundation's charitable purposes called in this report investment plus. A small number of US foundations pioneered investment plus in the 1990s. Its development in the US has been influenced by a number of factors including:

- a general growth in interest in and awareness of profitable companies with social purposes, a well known example is the Body Shop;
- the development of ethical-pooled funds for example, funds investing in companies aiming to achieve sustainable development or develop environmentally friendly technologies;
- the maturity of community development finance with some CDFIs proving themselves capable of offering healthy returns.

The decline in the stock market also encouraged some trustees to consider adopting a longer term and more diversified investment strategy including investment plus.

Since the late 1990s the number of US foundations engaged in shareholder action has increased – albeit from an extremely small base²¹. Some US foundations now consider that they have a fiduciary duty to vote on shareholder resolutions commonly called proxy voting. Few had considered this until the corporate scandals of the early 2000s, which significantly eroded the value of some foundations' assets. Some US foundations have also begun to see shareholder

14 – See note 6.

15 – HM Treasury responded positively to recommendations made by the Social Investment Task Force. For example, it committed funding to a community development venture fund and introduced a community investment tax credit. (See Annex 1 for a survey of recent UK government initiatives aimed at encouraging social investment.)

16 – Another related trend is that rather than developing an initiative on programme related investment and making a series of such investments some foundations have made only one or two significant programme related investments in their area of interest.

17 – According to a New Ventures report for the Ford Foundation published in 1984 and quoted in *20 Years: A report from the Cooperative Assistance Fund* (1988) before 1976 only 14 foundations made programme related investments (PRIs). Between 1976 and 1979 12 additional foundations became involved. Between 1980 and 1988 26 new foundations entered the field. By 2003, the Foundation Centre recorded 255 foundations making PRIs.

18 – They were also aware that the returned capital might come in handy at a time down the road when their mainstream investment portfolios were not looking so healthy - as has proved to be the case.

19 – J Emerson, *The Blended Value Map* quoting R Bowers (2003) *Socially Responsible Investing*, Cambridge Associates.

20 – A survey conducted by Just Pensions in 2003 found that 22 out of 57 of the largest UK charities, including foundations, responding to a survey negatively screened their investments. This compares with 7 who voted their shares, 6 who directly engaged with companies and 4 who positively screened their investments.

21 – The first foundation initiated shareholder resolution was filed in 1994 by the Jessie Smith Noyes Foundation.

During the 1999 proxy season, ten foundations co-filed and two filed shareholder resolutions – *President's Essay: Frequently Asked Questions About Mission-Related Investing*, Jessie Smith Noyes Foundation (1998).

action as an effective means of changing corporate policy on crucially important issues such as global warming – perceived as particularly important against a backdrop of government disinterest. It is believed that relatively few UK based foundations engage in shareholder action²².

Foundations, along with other institutional investors, have the voting power to exercise oversight of corporate conduct. Recent business headlines have shown that the lack of oversight severely diminished foundations' endowments and therefore, their ability to pursue their mission.

Caroline Williams, *Who's Minding the Store?* March/April 2003 issue of Foundation News and Commentary

Examples and case studies

The work of some UK foundations which are pioneers in social investment is described in the next section. Section 5 provide examples of US foundations acknowledged as leaders in the field. While US foundations consider that they have significantly more work to do to develop a robust knowledge base on approaches to social investment (see the box below) – there is greater and longer experience in the US on which to draw.

Neighbourhood Funders Group

The Neighbourhood Funders Group is a US based trade association for foundations and other philanthropic organisations supporting community-based efforts to improve economic and social conditions in low-income communities. The Group is currently developing an initiative on programme related investment for a number of foundations including: Annie Casey; Ford; MacArthur; Fannie Mae, and Rockefeller. It will develop a database of providers and consider how best to organise and deliver programme related investment. It will cover training for foundation staff and programme evaluation.

22 – See note 20.

4. UK examples – pioneering foundations

This section provides examples of UK foundations pioneering social investment. All the UK foundations featured in this section have made programme related investments.

Example 1: The Tudor Trust

The Tudor Trust aims to help break cycles of disadvantage and dependency and to prevent people from being drawn into these cycles. It funds in a number of priority areas including youth, older people, health, learning, housing, financial security and criminal justice. The Trust holds assets of around £250 million.

The Trustees seek to apply expendable endowment in pursuit of the Trust's charitable purposes. They recognise the need to be flexible and responsive. They endeavour to enable organisations to achieve their objectives; this includes helping them to move towards financial independence.

The Trust has made programme related investments over a number of years. Over 75 loans (most of them interest free) have been made since 1985, usually to assist in the purchase or refurbishment of properties. Loan and underwriting facilities have also provided development and working capital. This has enabled, amongst other things, Development Trusts to build an asset base, housing associations to provide housing for people who are inappropriately housed and a number of charities to purchase their own premises. In 1989 and 1990 equity-linked loans were made in partnership with a housing association to buy properties in East and South East London for letting at affordable rents. This was part of a package of measures to attract newly qualified teachers to work in these parts of London. When the need diminished the properties were re-valued and either sold back to the housing association or sold on the open market. This resulted in Tudor receiving not only the full repayment of the original loan but also a small surplus.

In 2004 programme related investments were valued at £2.4 million. The Trust holds equity in CAF Bank and Charity Bank and has made an interest free loan of £400,000 to Venturesome (see the box on following page). Recently the Trust has been investigating how to use its expendable endowment to provide a last resort underwriting facility held as a designated fund.

The Trust applies socially responsible guidelines when deciding which shares to invest in. Current policy includes positive screening. Trustees invest in growth potential and good financial return companies which demonstrate responsible employment practices, a conscientious approach to corporate governance and companies which are moving towards socially sustainable economic activity (for example, they are trying to reduce toxic omissions or are otherwise taking environmental issues seriously). The Trust also uses negative screens.

Specialist intermediaries in the UK

In a publication called *Lending Money: the issues for grantmaking trusts* published in 1997, Julia Unwin encouraged foundations to engage in social investment by supporting specialist intermediaries through grants or loans. The Social Investment Task Force report published in 2000 echoed this recommendation.

Specialist intermediaries well known to the charitable sector include Charity Bank, Venturesome and the Aston Reinvestment Trust:

Investors in Society/Charity Bank

Charities Aid Foundation (CAF) launched Investors in Society in 1996. It argued that voluntary organisations with the capacity to manage a loan and with revenue streams which could service repayments were being denied access to finance because mainstream banks did not understand voluntary sector funding models. Investors in Society was designed to fill this gap.

In 2003 Investors in Society became Charity Bank. Charity Bank is the first organisation in the UK with both charitable status and Financial Services Authority banking accreditation. In its second year of operation Charity Bank holds total funds of over £30 million and is seeking share capital and deposits to enable it to increase its lending.

Venturesome

In 2002 CAF established Venturesome to provide mezzanine finance ie risk finance in the space between a grant and a loan. It concentrates on underwriting and unsecured lending but has also provided quasi-equity²³. Its main market is charities but it has also participated in two social enterprise share issues. Venturesome has supported over 80 charities with £4 million and it is achieving its target recycling rate of 80 per cent.

Aston Reinvestment Trust

Since 1997, the Aston Reinvestment Trust (ART) has provided access to finance for small businesses and social enterprises in targeted areas of disadvantage in Birmingham. It lends at commercial interest rates.

Charity Bank and the Aston Reinvestment Trust are CDFIs in membership of the Community Development Finance Association. In 2004 foundations provided 7 per cent of CDFI funding. The majority of this financial aid is believed to take the form of grants rather than loans or equity²⁴.

Example 2: City Parochial Foundation

The City Parochial Foundation exists to benefit the poor of London. ‘The poor’ includes people who, for whatever reason, are socially, culturally, spiritually, environmentally and financially disadvantaged. Its current priorities include funding work which enables poor Londoners overcome discrimination, isolation and violence. It holds assets of around £160 million.

Ten years ago the Foundation invested in the development of a Resource Centre for voluntary organisations in Holloway in North London. The Centre rents serviced office space to voluntary organisations (at 25 per cent below market rates) and provides a venue for voluntary sector training and conferences. The Centre pays the Foundation a near commercial rent for the office and conference space and a commercial rent on the three shop fronts it has also acquired. It also makes a substantial one-off contribution to the Foundation each year, based on its out-turn for the preceding year. The Resource Centre is a charitable subsidiary of the Foundation.

The Foundation owns playing fields in Bellingham, a predominantly white, working class area in Lewisham. It has dedicated £1.2 million from its endowment and raised a further £3.3 million from other sources to develop a Sport and Healthy Life-style Centre there. The Centre also houses: Ladywell Gymnastics Club; a soft play area for young children; the largest Sure-Start project in London and an IT learning project. Opened in April 2004 it has already made a significant contribution to the regeneration of the area. The Bellingham Centre is owned by another charitable subsidiary of the Foundation – the Bellingham Community Project. It has leased the property to Greenwich Leisure; this not-for-profit organisation will manage the Centre for a ten year period. Greenwich Leisure will share profits with the Foundation but not losses.

Example 3: Northern Rock Foundation

The primary aim of the Northern Rock Foundation is to help improve the condition of those disadvantaged in society. The Foundation’s expenditure in 2004 totalled £26 million.

The Northern Rock Foundation sees making loans as a way of ‘adding to what we already do’. Its loan scheme, launched in 2003, is operated in collaboration with Charity Bank. Charity Bank undertakes due diligence checks on applicants for loans, undertakes monitoring and collects repayments.

23 – See the box in the next section for an explanation of quasi equity.

24 – Information provided by the Community Development Finance Association (CDFA).

In 2003 the Foundation made two loans of £15,000 each. During 2004 it made four loans with a total value of £968,000. Interest rates are normally 1 or 2 per cent above the Bank of England base rate. The majority of loans are secured. The money for the loan fund comes from the Foundation's reserves.

The Northern Rock Foundation is part of the Charity Bank led consortium delivering Futurebuilders – a Treasury supported fund aimed at helping voluntary organisations working in government's priority areas provide public services. The fund will focus on alternative forms of financing including loans, equity and quasi equity. Futurebuilders will offer some grants but only as an element of a package containing a loan or in the form of a development grant to organisations not yet loan ready.

Example 4: Esmée Fairbairn Foundation

Esmée Fairbairn Foundation funds organisations which aim to improve the quality of life for people and communities in the UK both now and in the future. The Foundation holds assets of around £740 million.

Esmée Fairbairn Foundation's loans programme was launched in 2003. It is a pilot programme to help test demand for loan finance in the voluntary sector. The Foundation has dedicated £3 million to the pilot over three years. Loans will be provided in the Foundation's programme areas: Arts & Heritage, Education, Environment, Social Change: Enterprise and Independence. Charity Bank provides due diligence assessments on loan applications and collects repayments.

During the pilot phase the minimum loan is likely to be £10,000 and the maximum £250,000. Interest rates range from 0 to 7 per cent. The Foundation will consider both secured and unsecured loans. So far loans have been made to individual charities and to intermediaries such as Venturesome and Portsmouth Savers Credit Union. Cash for the pilot comes from the Foundation's endowment.

The Foundation has, in addition, made a small number of programme related investments from its income or grants budget. These have included a loan of £150,000 to Investors in Society which was converted into an equity stake in Charity Bank, a loan of £200,000 to the Aston Reinvestment Trust (see page 15) and an investment in a ten year bond issued by Golden Lane Housing Ltd providing interest at 1 per cent above inflation.

Example 5: The Baring Foundation

The Baring Foundation has general charitable purposes. It has three specific grants programmes supporting respectively voluntary sector development, international work and the arts. It has investments of around £60 million. It has an equity stake of £50,000 in Charity Bank. This was converted from a loan to Investors in Society.

Example 6: The LankellyChase Foundation

Lankelly and Chase were until recently two separate foundations. They have merged to form the new LankellyChase Foundation. The Foundation holds assets of around £110 million.

£500,000 is earmarked in the accounts of the new Foundation for programme related investment. The Foundation is now considering both specifically how it should use these earmarked funds and more generally how it can use all its resources, both income and endowment, in pursuit of its charitable purposes. It is perhaps unique among UK charitable foundations in considering investment plus.

Example 7: Sainsbury Family Charitable Trusts

Members of the Sainsbury family have established a number of independent grantmaking trusts collectively known as the Sainsbury Family Charitable Trusts. Two of these, the Ashden Trust, which has investments of £20 million, and the JJ Charitable Trust, which has investments of

£20 million, have sought to make their resources go further through a limited number of programme related investments.

The Ashden Charitable Trust has made two programme related investments and has agreed a third. One is an interest free loan of £100,000 to Tropical Wholefoods. Tropical Wholefoods is a fair trade company which purchases dried fruit and vegetables from small scale producers in the developing world. It builds partnerships with small businesses in Africa and Asia to provide them with improved access to expertise and markets. In lieu of interest payments, the Trust took a 1 per cent (equivalent to £25,000) stake in the enterprise which it has given to another of its beneficiaries the Ashden Awards for Sustainable Energy. This loan enabled the Trust to avoid the issues that arise from holding equity and has enabled Tropical Wholefoods to grow its business substantially and thereby work with significantly more individuals and entrepreneurs in developing countries.

5. US case studies – pushing the boundaries

The case studies in this section illustrate how some US foundations are leading in developing particular forms of social investment.

Case study 1: The Hutton Foundation

Programme related investment and investment plus in property

The Hutton Foundation provides grants for education, health and community initiatives. It has an endowment of around \$70 million and has provided twenty five programme related investments ranging from \$100,000 to \$500,000 each. These have enabled voluntary organisations to purchase buildings, making an important contribution to their sustainability (the foundation is based in Santa Barbara in California and local rents are escalating). All their loans have been paid when due; they are offered over five to seven years with an average rate of return of 4.5 per cent.

The Hutton Foundation describes its programme related investment initiative as very simple to develop and easy to run. It uses the agreement developed for its first programme related investment as its standard documentation. It has a good relationship with a title company and a skilled attorney. It generally becomes involved near the end of the process when it is clear that the project will be viable.

The Hutton Foundation's fixed assets investment portfolio includes four large buildings which are leased back to small voluntary organisations. It concluded that it was not in the best interests of the smallest voluntary organisation to own its own buildings believing they would benefit from shared facilities including meeting and conference rooms.

Case Study 2: The Ford Foundation

Programme related investment and shareholder action

The Ford Foundation now restricts its programme related investments to organisations in receipt of a grant, previous grantees or organisations in the process of becoming grantees. It does this for various reasons. Firstly, to manage the huge demand for programme related investment. Secondly, because a grant relationship means it can build the capacity of the organisation to manage the loan – this makes repayment much more likely. Thirdly, programme officers have come to regard loan or equity finance as a means of enabling organisations to better achieve programme objectives.

The Ford Foundation makes two main types of programme related investments. It provides working capital for social businesses and capital to community development finance institutions for onward lending. Generally, only 1 per cent interest is charged and the capital is patient ie the loan term is ten years or more and repayment may not start until seven years have expired. The low interest rate enables onward lenders to cover their administrative expenses and provide loans at below market rates.

The Ford Foundation has an aggregate lending limit of \$200 million. The fund is structured so that a minimum of sixty five per cent of its lending has a maturity of ten years or less and a maximum of 35 per cent of the fund is in equity or loans with a maturity greater than ten years.

The Ford Foundation makes provision for 15 per cent losses. Its historic loss rate over the thirty six years of the fund's operation is a little more than this, because of difficulties in the early years (see page 11 for an explanation). Its attitude is that foundations developing similar programmes should expect to take some losses. Supporting new social businesses is risky because generally they are not diversified and a market may not exist or may only be temporary.

The Ford Foundation recently reviewed its programme related investment initiative. It identified a greater complexity in the deals it is being asked to participate in because borrowers have become more sophisticated. It is also more frequently being asked to provide subordinated loans (see the box below) to leverage private sector financing as well as support for more speculative ventures generally social businesses without a proven market niche.

The Ford Foundation has regularly voted its proxies for the last thirty years. The Foundation has developed guidelines for voting on a wide variety of social and corporate governance issues. Ford supplements staff advice on investment decisions with input from commercial proxy research services. It manages the process internally.

Often foundations make a PRI package that includes a loan or other type of investment, together with grants for operations, for technical assistance and/or for building the borrower's net worth – all things that help develop internal management capacity.

Francie Brody, Kevin McQueen, Christa Velasquez and John Weiser *Current Practices in Program-Related Investing*, Brody, Weiser, Burns (2002)

Equity and quasi equity

Foundations tend to follow a particular trajectory when they develop programme related investment initiatives. They often start by offering senior loans (they are first in the line of creditors). As they become more confident and as they see the benefits of loan finance they tend to offer subordinated loans where they are second or third in the line of creditors or they offer loan guarantees. The next stage tends to be to offer quasi equity or equity.

Quasi equity means that the funder takes a financial stake in the venture. So for example, in return for providing the working capital for the development of a new piece of software the funder might receive a percentage commission on each sale. In the UK both Venturesome and Futurebuilders have taken this form of quasi equity.

Taking equity is generally regarded as more problematic than providing straight loan finance. Firstly, the general rule in the UK is that charities can not offer equity – they are public benefit organisations without shareholders. However, foundations can take equity in non charitable voluntary organisations offering shares and private sector businesses where doing so enables the foundation to advance its charitable purposes. Secondly, equity implies a long term commitment – it may be difficult to realise the value of an equity investment. Thirdly, the foundation needs to take care that the organisation in which it has a stake does not alter its operations in such a way that it is no longer advancing the foundation's charitable purposes.

Case Study 3: The Cooperative Assistance Fund

Programme related investment

In 1967 John Simon President of the Taconic Foundation concluded that access to debt and equity was a major barrier to economic development efforts in minority and low-income communities. In response he drafted a proposal that a group of foundations 'join forces and set up a pooled fund' in which each foundation would agree to participate pro rata in 'high risk, low return' but socially useful business investments. Foundations could join the Cooperative Assistance Fund in one of two ways: by making an initial investment of at least 2 per cent of its assets or \$1 million whichever was lower, or by making annual grants to the Fund of at least \$100,000 a year. By 1969 the Fund had the following members: the Field Foundation; the Ford Foundation; New York Foundation; Norman Foundation; Ellis L. Phillips Foundation; Rockefeller Brothers Fund and the Taconic Foundation.

Over the nearly thirty years since its formation the Fund has tried a number of different approaches to programme related investment. However, it identifies some of its most successful investments as those made to specialist intermediaries. This is because such organisations are better equipped than the Fund to identify investment opportunities in their market areas, monitor their investments and provide strategies and technical assistance when needed.

Around twenty years ago the Fund developed the Cleveland Project. This project, which sought to support minority enterprise development in Cleveland, Ohio, was one of several attempts to mobilise investment capital at the local or regional level for minority ventures in geographically defined areas. Similarly, the Fund developed a systematic deposit programme for community development credit unions which agreed to make commercial loans to minority and other small businesses in their communities. It has also supported specialist intermediaries, for example an investment fund dedicated to the birth and growth of minority-owned radio and television stations. In all of these cases, the Fund sought to encourage capital support from mainstream lenders.

The Fund is now exploring the possibility of providing lead support for a national fund aimed at creating a strong secondary market in community development investments. This fund would facilitate the purchase of these investments from onward debt and equity investors, thus improving their liquidity and enabling them to provide new capital to enterprises in disadvantaged communities.

Case Study 4: The FB Heron Foundation

Programme related investment and investment plus

The FB Heron Foundation aims to build wealth in low income communities. It has led the field in the US in developing investment plus but it also provides programme related investment and has commissioned its own screening methodology.

In 1996 the Foundation began an investigation of how its endowment could be used to support its charitable purposes in response to concern from trustees that it was not using its resources to maximum effect. At first, fixed assets aside, it found relatively few investment options that would generate both a market rate of return and were related to its charitable purposes. It therefore decided that it would become involved incrementally pursuing only the most attractive investment plus opportunities. More recently, it has helped develop the sorts of products it aspires to invest in.

As a start the Foundation made a few deposits in community development credit unions. Since it has purchased asset-backed securities issued by Habitat for Humanity, enabling the expansion of the organisation's self-help housing programmes. It has bought municipal bonds that provide 'soft-second mortgages' for low-income first-time homebuyers. It has invested in private equity funds supporting commercial real estate projects in low-income communities and financing for businesses that wish to relocate to them.

24 per cent of Heron's portfolio helps to achieve its charitable purposes. Investment plus was the highest performing segment of its portfolio in the period from 2000- 2002, until the equity markets rallied in 2003. Investment plus has not changed the Foundation's asset allocation. It remains indistinguishable from many foundations at 65 per cent equity, 25 per cent fixed income and 10 per cent alternative investments. Its total return of 21 per cent in 2003 placed it at or above the median for foundations and endowments in several investment surveys.

The Heron Foundation commissioned Inovent to develop an index screening methodology for Russell 1000 companies. The Foundation is interested in levels of community investment and quality of employment practices. The study found that the 250 companies which demonstrated superior performance on these issues outperformed the index. The Heron Foundation is considering developing a portfolio of these 250 companies as a separate bond account that others could invest in.

Case study 5: The Nathan Cummings Foundation

Shareholder action

The Nathan Cummings Foundation seeks to build a socially and economically just society that values and protects the ecological balance for future generations; promotes humane healthcare; and fosters arts and culture that enriches communities. It has around \$450 million in assets. It does not provide programme related investment or screen its investments. It considered these approaches and decided they would be too administratively complex and therefore expensive to implement. It decided instead to engage in shareholder action to: positively influence corporate governance; deal with transparency issues, for example the reporting of environmental impacts and address negative effect of corporates on health and the environment (see the box below for an example). It works in collaboration with other voluntary organisations and pension funds, particularly the big public sector pension funds sharing resources for research and administration.

An example of a shareholder resolution

In 2002 the Nathan Cummings Foundation made four grants totalling \$650,000 aimed at holding big agribusiness environmentally accountable. At the same time it had shares valued at around \$720,000 in Smithfield Foods, a hog producer with a poor environmental record. After the Chief Financial Officer noticed this discrepancy, the Foundation placed a resolution on the company's ballot paper. It noted that Smithfield 'has been cited for serious environmental violations, most notably from the breaching of hog waste lagoons into public waterways'. It points out that these pose not only environmental but also 'financial and reputational risks'. It asked the management to prepare a report describing the environmental impacts of its hog production operations. 20 per cent of shareholders voted in favour of this resolution. Smithfield will soon release an environmental impact report.

The investment manager who bought this stock for us [Smithfield] may have found it an attractive investment for the near term but we question the long term viability of a business model with such negative impacts.

Caroline Williams, Chief Investment and Financial Officer, Nathan Cummings Foundation quoted in J Emerson's (Summer 2003) *Where Money Meets Mission: Breaking Down the Firewall Between Foundation Investments and Programming*, Stanford Social Innovation Review

Case study 6: The Jessie Smith Noyes Foundation

Negative screening, investment plus and shareholder action

The Jessie Smith Noyes Foundation provides funding for environmental and reproductive rights work. Its endowment is around \$60 million. Prior to 1990 the Foundation had a very traditional investment portfolio. This changed as individuals with broader investment experience were invited onto the Board. One new board member was a committed environmentalist and had venture capital experience. He helped to craft a new investment policy so that 10 per cent of the portfolio would comprise alternative investments including venture capital. On this basis the Foundation invested in environmentally sustainable community focused companies. The equity it took in Stonyfield Farms, an organic farm produce company, generated an excellent return (the company was eventually bought by Danone). Other ventures including Deja Shoes, a recycled shoes and organic clothing company, were less successful. In 2003 the Foundation decided to pursue this form of investment through pooled venture capital funds.

The Noyes Foundation has a policy on screening its investments. The first board of the Foundation, the family members, agreed that they did not want to own shares in tobacco companies and nuclear power. Its current policy sets out exclusionary screens and inclusionary screens related to the mission of the Foundation. For example, it wishes to exclude companies that are significant producers of synthetic agricultural chemicals such as pesticides and fertilisers and to include companies that produce, distribute or sell organic food. Trustees have

agreed that no more than 20 per cent of their portfolio should be in unscreened stock. They invest in Domini Social Investing – a screened fund. Where they are investing in unscreened funds they have discussions with the fund managers about any investments that might violate their policy.

The Foundation manages proxy voting on unscreened funds in-house. On average it votes 200 of these each year. It also writes to and holds meetings with companies in which it has investments to discuss issues of concern.

Noyes has concluded that the financial risk in mission-related²⁵ investing is no different from the risk inherent in any asset class. Given the large universe of publicly traded stocks and bonds, a skilled money manager who applies mission related screens is as likely to achieve his benchmark goals over time as a manager who has no screens.

Stephen Viederman and Miriam Ballert *President's Essay, Frequently Asked Questions About Mission-Related Investing*, Jessie Smith Noyes Foundation (1998)

Proxy voting and investment managers

Fund managers are obliged to vote customer proxies as part of their management service. A UK expert referred to the difficulty of asking fund managers to undertake proxy voting in line with the policy of a particular foundation. They often have the funds of numerous clients invested in a single company. They therefore tend to adopt a lowest common denominator approach when they vote proxies, generally supporting the position of the company's management. Ensuring that they vote in accordance with the Foundation's wishes therefore generally needs to be discussed with them on a case by case basis.

Some investment managers however, contract with specialist companies who vote their proxies in a socially responsible way. Foundations who use managers with such contracts can request that the manager invests the shares in their accounts through this service.

Some US foundations vote their own proxies – see case studies 2 and 6 in this section.

Case study 7: The Calvert Social Investment Foundation

Providing services to foundations and developing social investment products

The Calvert Social Investment Foundation was set up to popularise community investing both amongst the general public and foundations.

Raising funds from the general public

It has no endowment and sells community investment notes to finance its lending. These notes, investment minimum \$1000, pay a fixed, below market rate of interest, determined at the time the investment is made, for the term of the note (five, seven or ten years). The Foundation has sold notes valuing \$80 million. Notes valuing \$62 million were bought by the general public, notes valuing \$18 million by the private sector financial institution that established the Foundation. It has 170 borrowers and \$74 million has been lent on.

Providing programme related investment

The Foundation has been providing programme related investments for ten years. It has a total loan portfolio of \$75 million. It has had to write off only \$125,000. It supports organisations with a good track record, in which other financial institutions have demonstrated confidence.

25 – See the box on page 8 which discusses definitions.

It generally asks for 4 per cent interest. This is seen as expensive finance so organisations in difficulty generally want to repay while they have some liquidity. Each prospective loan is given a risk score and this determines monitoring levels. The Foundation has a small fund of \$1.2 million, funded by donations, from which they make higher-risk, high-impact loans.

Supporting foundations

For a fee the Foundation provides expert services to foundations providing programme related investment. For example, it undertakes due diligence checks and monitors loan repayments undertaking this work for some of the largest US foundations including MacArthur. It also helps smaller foundations by developing customised loan portfolios for those wishing to invest as little as \$500,000. It matches the contributions of these smaller foundations.

6. The pros and cons of different approaches

The examples and case studies provided in the last two sections illustrate that foundations with an interest in social investment often adopt a pick and mix approach. They may provide programme related investment to individual organisations or to specialist intermediaries - often they will do both. They may deploy investment plus and make programme related investments. Some develop an integrated approach combining programme related and investment plus, wider investment screening and shareholder action. This section considers each of the different approaches to social investment – their pros and cons and critical success factors.

a) providing programme related investment to individual organisations

Some UK and US foundations provide loans and equity alongside grants to individual organisations. They report that they do this for a number of reasons, to:

- deploy a range of funding tools – sometimes loans and equity are better suited to particular projects than grants (see the box on page 25/26 – programme related investment helps voluntary organisations);
- make their money go further – recycling enables foundations to support more organisations;
- help organisations develop their capacity – loan finance requires a higher degree of financial discipline than a grant;
- help organisations become more sustainable over the longer term – organisations acquire an asset or develop an income generating service;
- leverage more capital investment, including mainstream investment, into the voluntary sector;
- improve the terms on which voluntary organisations are offered finance ie enabling organisations to access larger amounts of capital or finance at a lower cost.

Foundations in the US report that they can give larger programme related investments than grants. They also suggest that provision of loan finance deepens the relationship between the foundation and the recipient because generally it is a longer term commitment and requires greater scrutiny of organisational capacity. One UK foundation reported that this presented difficulties. Foundations in the UK generally regard themselves as arms length funders ie they do not consider it appropriate to become too involved in the management and governance of organisations. Effective management of a loan or equity arrangement may require a more interventionist approach.

Successful programme related investment initiatives tend to have the following characteristics:

- lending is to organisations rather than individuals;
- either the organisation receiving the finance or the sector in which it is working is well known to the foundation;
- foundations make clear at the outset whether or not they are prepared to convert loans into grants and in what circumstances;
- foundations do not attempt to do all the work themselves but engage specialist agencies (see examples 3 and 4 in section 4 and case study 7 in the previous section) to undertake due diligence checks, monitoring and receipt of payments on their behalf;
- programme related investments form part of a more comprehensive package of support including grant funding and support and assistance with capacity building.

Programme related investment opportunities come in many forms and some are riskier than others. Some foundations have decided to specialise in flavours of programme related investment where risks are limited either because of the nature of the investment or the use of intermediaries (see the first case study in the previous section and examples 3 and 4 in section 4).

For the foundation, a program related investment actually becomes a grant that 'keeps on giving' as the foundation itself receives a reasonable return on its investment.

Tom Parker, *The Benefits of Program-Related Investments*, Association of Small Foundations, Vol 3 (Number 4) 1999

Now that the stock market has taken a significant downward turn the recycling of charitable dollars through PRIs should be even more appealing.

Francie Brody, Kevin McQueen, Christa Velasquez and John Weiser, *The Benefits of Program-Related Investments*, Association of Small Foundations. Vol 3. No 4 (Winter 1999/2000)

Programme related investment helps voluntary organisations

Programme related investment can take the form of both capital and revenue finance. It can help voluntary organisations in a number of ways:

Pre-funding of fundraising – sometimes voluntary organisations want to take advantage of a particular offer, for example a fixed contract price for building work before they have raised sufficient funds to cover the cost. A loan enables them to take advantage of the offer.

Provision of working capital – an organisation may have secured funding but may have to wait to receive it (for example, payment terms are quarterly in arrears). Working capital underpins cash flow in the short term.

Provision of development capital – development capital enables organisations to invest in training or new facilities and equipment. Often this investment enables organisations to develop income streams which secure their viability over the medium to long term.

Provide leverage – through loans or loan guarantees – helping organisations access greater sums of money or finance on better terms, often from mainstream banks. For example, if an applicant for a loan receives a programme related investment from a foundation this can help persuade a bank that the risk of default is reduced.

Maintaining liquidity – some US foundations are working to develop secondary markets in loan finance. They effectively 'buy' loans in order to provide lenders with the liquidity they need to enable them to make more loans. So, for example a foundation in the US takes onto its books some of the lending of a CDFI, releasing funds to the CDFI to lend on.

Examples:

JJ Charitable Trust

Merlin provides medical relief and health care for people caught up in natural disasters, conflict, epidemics and health system collapse worldwide. Over the last few years the organisation has responded to a number of emergencies including those in Iran, Afghanistan and the Democratic Republic of Congo. It helps more than 15 million people annually in up to 20 countries.

The trustees of the JJ Charitable Trust made a loan facility of up to £50,000 available to Merlin in April 1999. The loan provides interest free, working capital to enable the organisation to respond swiftly to emergencies without causing undue pressure on its finances. Merlin is funded by grants from statutory sources which are paid in arrears. Without the loan, which has been recycled many times, the organisation would have to pay high bank charges.

Venturesome

Inside Out Trust (IOT) develops and supports workshop projects in prisons. Offenders work voluntarily to provide goods and services for the benefit of other people. This 'restorative' work helps them to build their confidence and self esteem. Offenders gain skills and qualifications that help them to secure a job on release, and to lead law-abiding and constructive lives. IOT makes an important contribution to the criminal justice system in the UK, both through its direct work and indirectly through advocacy.

IOT's newly appointed Director contacted Venturesome in summer 2004. Difficulties with a major contract had led to a funding crisis. Venturesome and the Director agreed that the charity required both development capital to underpin reserves and working capital to assist cash flows. Venturesome provided £35,000 in development capital – as an unsecured medium term loan, with repayment linked to the level of reserves over five years, and a £65,000 working capital facility, repayable from cash flow.

b) providing programme related investment to specialist intermediaries

Many foundations have decided to make programme related investments to intermediaries, generally CDFIs. The approach has the same general advantages and disadvantages set out above. It also enables foundations to:

- provide larger amounts of capital to disadvantaged areas or areas of activity;
- reduce the transaction costs associated with loans or the purchase of equity ie it would be expensive in both time and money for a foundation to develop all the necessary skills in house;
- mitigate the risk of investing capital direct into particular communities or areas of activity.

Specialist intermediaries:

- pool risk across a large number of loans thus reducing investor exposure;
- are experts in assessing and managing the financial risks associated with the projects they support;
- know the communities and markets in which they are investing;
- are in business to recover - borrowers may assume that foundations will not pursue the debt.

A number of US foundations have a long history of supporting community development finance intermediaries. These foundations have had the satisfaction of seeing community development finance grow, with some help from US governments, into a strong force. It is now a multi-billion dollar market²⁶.

Foundations supporting specialist intermediaries in both the US and UK identified no particular disadvantages to the approach. Some US foundations not working in this way expressed concern that some specialist intermediaries have high 'hidden' administration costs. One US foundation also commented that most CDFIs are geographically focused and it is difficult for foundations with a national remit to justify limiting their support to one or two geographical areas.

A number of foundations both in the US and the UK have also supported the development of social investment by providing grants to specialist intermediaries (see the box opposite).

26 – According to the US Social Investment Forum, the assets flowing into community investing organisations grew by 84 per cent between 2001 and 2003, increasing from \$7.6 billion to \$14 billion. This includes \$2.7 billion of assets in Community Development Credit Unions and \$3.6 billion of assets in Community Development Loan Funds.
2001 Report on Socially Responsible Investing Trends in the United States.

When a PRI program is new or when the number of PRIs in a foundation portfolio is too small to balance risky investments with more secure ones, investing in experienced intermediaries enables a foundation's staff to be relatively confident of both the program impact and financial security.

Frances Brody, John Weiser, Scott Miller, *Matching Program Strategy and PRI Cost*, Brody, Weiser, Burns (undated)

Grant giving in support of intermediaries/new initiatives

Giving grants to specialist intermediaries helps to:

- establish new markets, for example CDFIs and the provision of community development finance;
- test emerging initiatives for example, new bond issues where the finance has a social objective.

Grant funding can and has enabled intermediaries to:

- set up in the first place;
- build a capital base including a reserve against bad debt;
- reduce their interest rates or other charges;
- develop funds supporting higher-risk but potentially higher-social-return ventures;
- test and promote new financing methods thereby increasing access to capital for social projects;
- provide non-income-generating services to local communities or within particular social markets;
- cover the transaction costs of the income and non-income-generating services described above.

A number of the UK and US foundations whose work is highlighted in this report have provided grants to intermediaries, for example the Ford Foundation, Esmée Fairbairn Foundation, and Northern Rock Foundation.

c) screen investments and/or engage in shareholder action

The main issues both foundations in the US and UK cite as a barrier to investment screening are:

- the time and effort involved in developing a credible screening policy particularly since discussion may at the margins raise difficult ethical issues on which trustee views may differ;
- numerous subjective judgements have to be made in implementation (ie this practice is tolerable but that is not) – these often involve fine distinctions which some consider don't stand up to scrutiny;
- screening means additional work for fund managers and this increases the charges they make for their services.

Those US foundations that appear to have engaged productively with investment screening and to find its implementation the least problematic have a number of features in common:

- one or more of their trustees has a strong commitment to socially responsible investment;
- their screening policy is a perfect fit with their purposes – they therefore have considerable expertise on which to base screening decisions;

- they take a pragmatic approach and do not expect the process to be perfect ie only a proportion of their investments are screened and they invest in funds subject to standard screens (ie not with direct equivalence to their policy) but they discuss with fund managers any potential breaches raising particular concern.

Shareholder action has the following positive features:

- compared with other methods of social investment the transaction costs are low;
- the numbers of organisations engaged and their influence (particularly that of the large pension funds) means that the burden of research and administration is shared;
- there are now a number of sources of help and advice.

Some see it as a preferable alternative to other forms of social investment because it is simple. They can invest in what they like: some say the more heinous the company the better, since the objective is to improve corporate practice. If foundations succeed, and shareholder action appears to be having some effect in the US, they have performed a significant public service. Some foundations, those not engaged in it, wonder however, if it really makes a difference to company practice or whether companies simply gesture in response.

Many foundations screen only a portion of their portfolio in order to become comfortable with the process over time.

Stephen Viederman and Miriam Ballert, *President's Essay, Frequently Asked Questions About Mission-Related Investing*, Jessie Smith Noyes Foundation (1998)

The key obstacle is trustees' perception that ethical or socially responsible investment policies will lead to lower returns and therefore harm charities' ability to fund their work. The available research suggests these fears are not well founded.

Duncan Green, *Do UK Charities Invest Responsibly? A survey of current practice*, Just Pensions (2003)

d) investment plus

Like programme related investment, investment plus, takes a variety of forms (see the box opposite). The main advantage of investment plus is that it enables foundations to:

- maximise their impact – they apply part of their capital as well as their income to achieving their charitable purposes;
- further diversify their portfolios thereby spreading risk over the longer term;
- contribute to the development of a market in investment plus in particular asset classes – this holds the promise of generating wider and more profound change in general investment patterns.

The barriers are:

- a lack of trustee awareness and confidence in the approach – and a deep seated fear of erosion of capital;
- a desire on the part of trustees to keep things familiar and simple – many believe in the merits of the silo approach;
- investment plus means that trustees, as guardians of the organisation's charitable purposes, generally play a more active role in decision making about investments – some prefer the delegation to specialist advisers or firms;
- a comparative scarcity of investment plus opportunities in certain asset classes.

Investment plus also tends to be regarded as complex and demanding. However, some types are relatively easy to deploy for example, investment plus in property (see the first case study in the previous section). Those US foundations which have a significant stake in non-fixed asset investment plus, to guard against erosion in their capital base, tend to:

- invest in companies operating in markets in which they have expertise for example, in companies with environmental goals;
- use pooled funds, for example social venture capital funds in order to reduce risk;
- chose only to invest in the highest quality investment plus opportunities;
- use industry benchmarks for particular asset classes to monitor performance – making adjustments in their portfolios as necessary;

Given the comparative shortage of investment plus options in particular asset classes, such investments make up only a relatively small proportion of the portfolios of even the most actively engaged foundations. Because of this shortage, some of these foundations are helping to create investment plus products.

Investment plus

Investment plus can take a number of forms. Foundations can invest in companies:

- producing products or services which advance the foundation's charitable purposes for example, environmental improvement or funds comprising such companies (see case study 6 in the previous section);
- owned, managed or employed by a sector of the population the foundation aims to help, for example women or people with disabilities;
- located in disadvantaged areas in cases where the foundation has charitable purposes dedicated to employment creation or regeneration (see case study 4 in the previous section).

Such investments may be classed as conventional, ie they may be in well established mainstream business, or they may be classed as 'alternative investments' because for example they take the form of venture capital in emerging for profit businesses whose viability has not been tested (see case study 6 in the previous section).

Property also provides investment plus opportunities for foundations (see the first case study in the last section).

7. Conclusions

The experience described in this report demonstrates that a number of pioneering foundations are making social investments and working to promote the approach amongst their peers. However, although much impressive work has already been done, most agree that the journey is only just beginning.

Why social investment can be difficult

Most of the foundation experts interviewed during the preparation of this report described an initial resistance to social investment amongst some trustees only overcome through the strong advocacy of new trustees or well respected advisors. This initial resistance is understandable – social investment departs from the orthodoxy about how charities make and deploy their funds.

Social investment generally:

- requires foundations to review or adapt their processes and to develop or buy in new types of expertise which means increased transaction costs;
- changes relationships with recipients – loan or equity relationships are often longer term and more engaged and some foundations consider this an uncomfortable departure from their traditional mode of operation.

Social investment is therefore perceived as having disadvantages but foundations using social investment approaches are doing so because they believe the advantages far outweigh the disadvantages.

Why do it?

Social investment enables foundations to achieve greater impact with the resources available to them:

- **Programme related investment** enables foundations to recycle funds and helps build financial and management capacity in voluntary organisations.
- **Socially responsible investment** means that foundations invest their capital in ways that at worst do not erode and at best support the common good.
- **Investment plus** enables foundations to use part of their capital to advance their charitable purposes.

Programme related investment also fills a financing gap. It is generally acknowledged that difficulties accessing capital hampers voluntary organisations' ability to develop income generating services, which could in the medium to longer term help them to achieve greater sustainability. Such investments (and investment plus) can also have an impressive multiplier effect. In the US programme related investment has prompted significant expansion in community development finance leveraging in private sector funds.

[While grants are a legitimate and necessary form of funding helping organisations achieve their purposes]...It is important that full grant subsidy is only used when no other form of finance (earned, borrowed or self-generated) can be more (or as) effectively used to deliver a specific public benefit.

David Carrington, *Financing the voluntary and community sector-future prospects and possibilities in Voluntary Action: meeting the challenges of the 21st Century*, NCVO (2005)

Key findings

This report demonstrates that there are a number of ways that interested foundations can explore social investment. The previous section discussed these approaches, their pros and cons and critical success factors. In considering this issue, foundations might also wish to take account of the following points which emerge from the UK examples and US case studies set out respectively in sections 4 and 5:

Small and medium are beautiful

Many of the foundations which have successfully engaged in social investment are small or medium sized foundations. Such foundations have used this investment as a means of achieving greater impact with limited resources. Some providing programme related investment have successfully pursued strategies aimed at limiting its risks.

Foundations that have made PRIs range in size from less than \$1 million in assets to more than \$10 billion. Of those foundations that regularly make PRIs or have a PRI program, most have 1 per cent to 5 per cent of their assets invested in PRIs.

Francie Brody, Kevin McQueen, Christa Velasquez and John Weiser, *Current Practices in Program-Related Investing*, Brody, Weiser, Burns (2002)

Stimulate trustee interest and support

All the US foundations developing innovative approaches to social investment highlighted in this paper had strong advocates for the approach on their boards. These advocates invested time and energy in building support across the organisation.

Experience suggests that a committed board member – willing to champion the issue of mission related investment²⁷ and to work until there is a resolution is essential... Noyes has found that the very process deepens and strengthens the boards understanding of our mission and our values, which is of great value whether or not we have changed the world through the investment process.

Stephen Viederman and Miriam Ballert *President's Essay, Frequently Asked Questions About Mission-Related Investing*, Jessie Smith Noyes Foundation (1998)

Experiment by allocating a small percentage of funds to social investment

Most foundations engaged in programme related investment and/or investment plus have allocated only a small proportion of their funds to the approach. This allows for experimentation. The reality is that most foundations, at least for some time into the foreseeable future, will continue to focus mainly on grants and conventional investment.

27 – See the box on page 8 which discusses definitions.

Vary approaches to risk

Programme related investment is regarded as risky by most foundations. There is the reputational risk that funds will not be returned or that the return will be lower than promised – a risk not present when grants are awarded. The case studies in section 5 illustrate that different types of programme related investment carry different levels of risk and foundations can choose a level of risk exposure with which they are comfortable.

Different aspects of the programme determine its level of risk, these include the nature of:

- the organisations supported – the key question is whether they and/or the market in which they operate are well known to the foundation;
- the projects supported – for example whether they are building projects and rental income will cover repayments, or whether they are new social ventures for which the market is untested;
- the terms on which loans are offered – for example, whether the foundation is first or second in the line of creditors and whether the loan is expensive or not (if they hit trouble organisations will seek to pay off expensive loans first).

Another important factor is the extent to which the foundation works through specialist intermediaries or obtains specialist advice.

Use/support intermediaries

Many of the foundations that have developed successful programme related investment and investment plus strategies have worked with or through specialist intermediaries, for example Venturesome in the UK or the Calvert Social Investment Foundation in the US. Foundations can be reluctant to support intermediaries preferring instead to provide finance direct to organisations working at the front line.

However, investing in specialist intermediaries significantly reduces the risk of either losing money or not garnering the expected return.

Foundations in the UK and US can and do support specialist intermediaries in a number of ways by:

- making grants which reduce the price of borrowing;
- taking an equity stake to capitalise the specialist intermediary;
- making a loan to the intermediary to help it finance its loan programme;
- purchasing services from the intermediary, for example due diligence, monitoring and repayment services to support programme related investment initiatives;
- ‘buying’ part of the intermediaries loan fund ie a portion of the loan fund is transferred onto the foundation’s books recapitalising the intermediary so it can make more loans.

Acknowledge programme related investment as a tool in the funding armory

Programme related investment is now generally regarded in the US as a valuable ‘supplementary tool for grant makers’ to be used alongside grants in appropriate circumstances. In some successful initiatives programme related investment forms part of a larger investment package that includes a grant and advice and support with capacity building. A Ford Foundation review of its first twenty years of programme related investment said: ‘Judiciously applied grant funds help improve the likelihood of the project’s success and repayment of the programme related investment. Grants may also serve as seed capital to test a new project before a loan is made and the project ‘goes to scale’ with a larger financial investment’.

Acknowledge the opportunities for investment plus

This report demonstrates that generally foundations have less experience of investment plus in part because it is difficult to find appropriate high quality investment opportunities. However there are likely to be some high quality investment plus opportunities in certain fields, for example environmental protection and conservation. And, as the growth in businesses with explicit social purposes continues, such opportunities will increase in number.

Develop new investment plus products

The Heron Foundation in the US has shown how foundations can support the development of new investment plus products.

Tie investment screening policies to charitable purposes

Those foundations successfully screening their investments generally have policies tied to their charitable purposes. This sounds like a truism. However, foundations which attempt a broader approach tend to get into difficulties because they are forced to make fine subjective judgements in policy areas in which they lack expertise. By contrast, a foundation which supports environmental improvement with a screening policy concerned with environmental practice is likely to have the knowledge base to make the necessary judgements.

This report attempts in part to survey US experience. If that experience is anything to go by it is likely that in the future an increasing number of UK foundations will make social investments and that such investments, and grants and fees for services related to social investment programmes, will enable the growth of specialist intermediaries. This growth is in itself likely to encourage the market to develop as intermediaries gain expertise, promote their work and advertise the services they can offer foundations and others.

The likely picture over the longer term is of a market gaining maturity in which programme related investments are likely to be:

- more common – there is likely to be growing demand for subordinated loans or loan guarantees;
- more complex – they may involve multiple parties and higher proportions of private finance;
- more speculative – there are likely to be an increasing number of requests for support for more speculative ventures, particularly social businesses without a proven market niche.

An increasing number of foundations are also likely to engage in socially responsible investment, including investment plus. In this scenario foundations making social investments make money work harder by leveraging more finance into undercapitalised voluntary organisations and other social businesses, thereby increasing the limited resources available for projects which break the mould of existing products or services or which meet needs previously ill catered for or ignored.

Annex 1

UK government programmes or policy initiatives

The Phoenix Fund

The Phoenix Fund was launched in 1999 as a response to the Policy Action Team report *Enterprise and Social Exclusion*. Its aim is to facilitate access to finance and business support in disadvantaged communities. A particular emphasis is placed on support for women and ethnic minorities. The £150 million fund also promotes the creation and development of social enterprises. It currently provides, among other things, capital, revenue and loan guarantee support for CDFIs and supports the Community Development Venture Fund (see below). It has funded the establishment of the CDFA.

Community Investment Tax Relief*

The 2001 budget introduced a community investment tax credit. This is available both to individuals and corporations (but not charities) investing in accredited CDFIs. The tax relief is five per cent of the amount invested. By June 2004 twenty three CDFIs had been accredited.

Community Development Venture Fund*

Bridges Community Ventures was launched in 2002 to invest in ambitious businesses in under-invested parts of England. The UK government committed £20 million to the fund, which was matched by £20 million investment from the private sector. The scheme focuses on for profit businesses. Following numerous requests from not for profit businesses consideration is being given to the establishment of a more socially focused fund.

HM Treasury's Cross Cutting Review

The Treasury's Cross Cutting Review examining the role of the voluntary and community sector in public service delivery published in 2000 proposed the development of a new funding scheme to build voluntary sector capacity to provide public services. The new scheme Futurebuilders, predominantly a loan scheme, announced its first awards in 2005.

Community Capacity Building

The Home Office is one of a number of government departments funding the Adventure Capital Fund. It aims to test different models for financing community based enterprises. It has provided grants, underwriting and unsecured loans (including loans where repayment depended on the organisation being able to afford it) in support of community capacity building.

Social Enterprise Strategy

In 2002 the UK Department of Trade and Industry (DTI) published a strategy on the development of social enterprise called *A Strategy for Success*. It considered access to finance by social enterprise and recommended that the Bank of England consider the issue. The Bank of England report published in 2003 made a series of recommendations both about how to stimulate appropriate provision and demand for it.

The Prime Minister's Strategy Unit Voluntary Sector Review

The Strategy Unit review which produced the report *Private Action, Public Benefit* recommended the development of a new legal structure called the Community Interest Company (CIC). CICs will be able to access capital by issuing preference shares. The report also said that larger charities should be required to declare their investment policy including their policy on ethical investment.

* These policy initiatives signaled a positive government response to recommendations in the Social Investment Task Force report.

Annex 2

Interviewees

Shari Berenbach	Calvert Social Investment Foundation
Francie Brody	Brody, Weiser, Burns
David Carrington	Independent Consultant
David Cutler	Baring Foundation
Fiona Ellis	Northern Rock Foundation
Frank DeGiovanni	Ford Foundation
Victor De Luca	Jessie Smith Noyes Foundation
Kathleen Enright	Grant Makers for Effective Organisations
Victoria Hornby	Sainsbury Family Trusts
Peter Kilgariff	The LankellyChase Foundation
John Kingston	Venturesome
Spence Limbocker	Neighbourhood Funders Group
Lance Lindblom	Nathan Cummings Foundation
Char Moll	Council on Foundations
Tom Parker	The Hutton Foundation
Nicola Pollock	Esmée Fairbairn Foundation
Luther M Ragin, Jr	The FB Heron Foundation
John Simon	Cooperative Assistance Fund

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