EXECUTIVE SUMMARY

Compounding Impact:
Mission Investing by US Foundations

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Funded by
the David & Lucile Packard Foundation

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

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

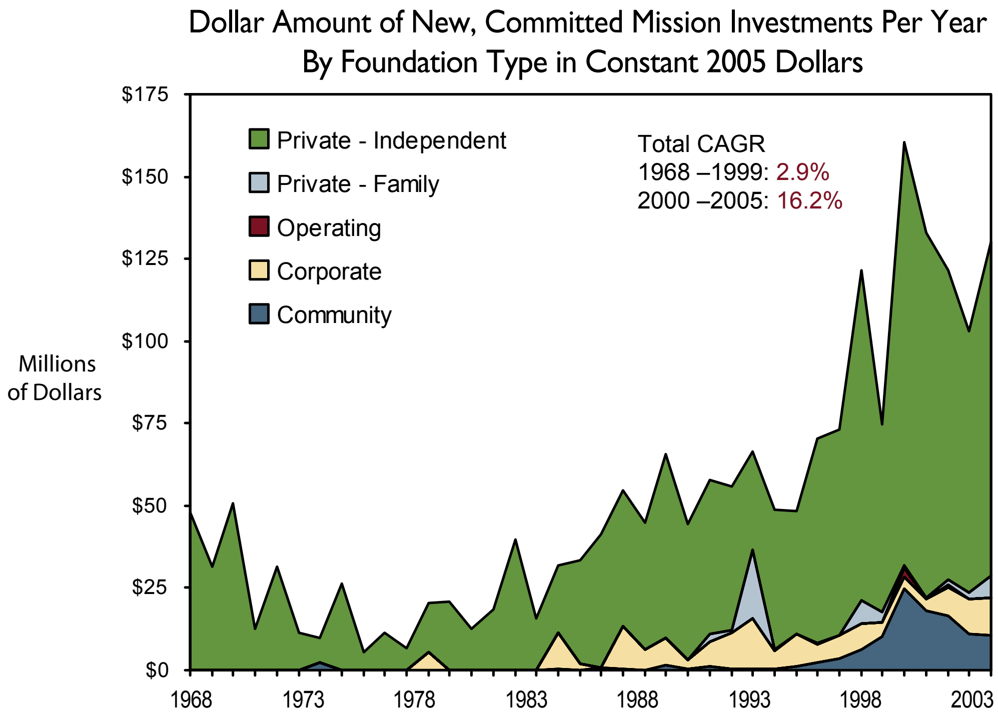
Mission investing is gaining momentum among US foundations. Recently, the use of mission investments, including program-related investments (PRIs), has been expanding rapidly. Mission investments' annual growth rate averaged 16.2% in the last five years, compared to just 2.9% during the preceding 32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

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

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

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

This Executive Summary is excerpted from FSG's detailed report on mission investing available at **www.fsg-impact.org/app/content/actions/item/182**

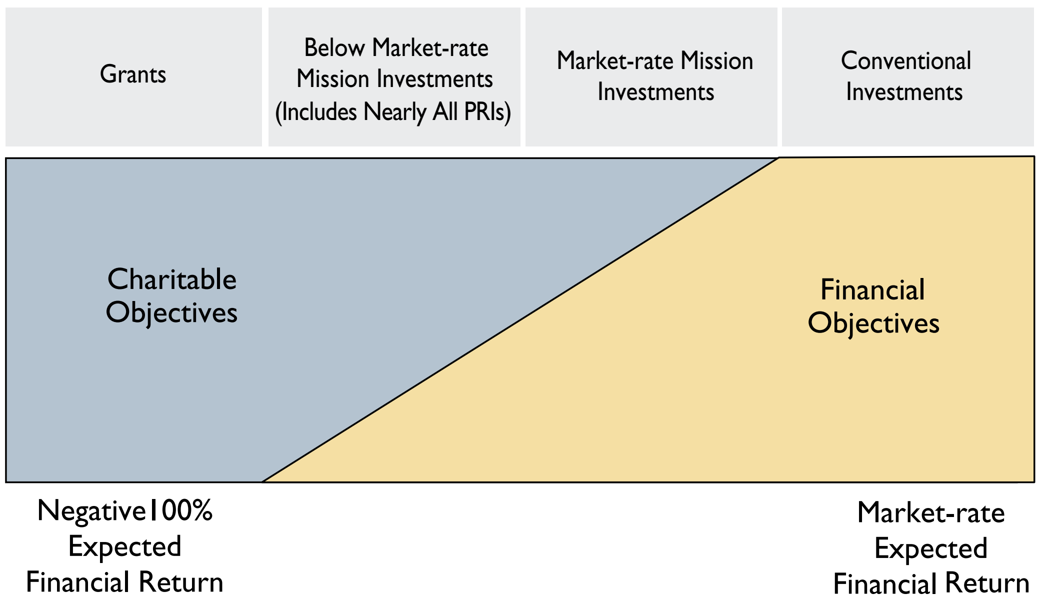


Notes: In constant 2005 dollars based on annual average CPI, all urban consumers as reported by the US Dept of Labor. To avoid major swings due to periodic investments, one foundation's infrequent and large equity investments are not included in this trend analysis. The first year of mission investing was not available for $120M of investments – they, therefore, are not included in this analysis.

[1] In constant 2005 dollars based on annual average CPI of all urban consumers as reported by the US Department of Labor.

[2] The majority of the participating foundations provided data on their individual investments. Those that did not cited a lack of staff to gather the information requested.

Spectrum of Foundation Investments



Mission Investments Defined

Mission investments are financial investments made with the intention of (1) furthering a foundation's mission and (2) recovering the principal invested or earning financial return. Mission investments can take the form of debt or equity and can be funded by either program or endowment funds.

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Mission investments can be grouped into two broad categories:

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

Approaches

Foundations can take three approaches to mission investing:

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

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

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

Motivations

Foundations have three primary motivations for mission investing:

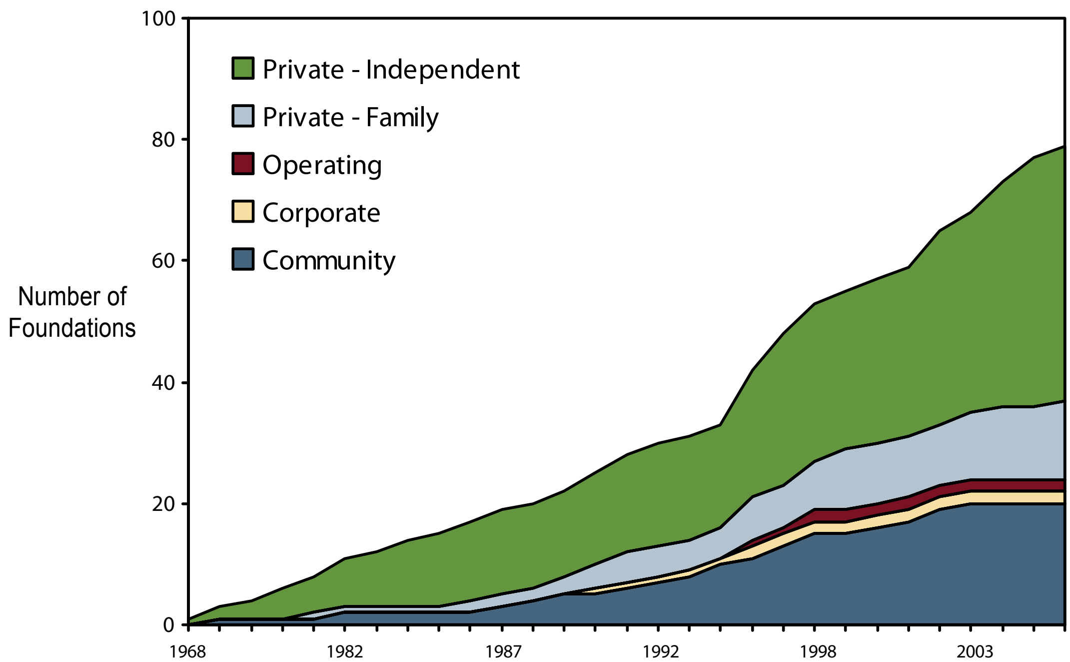
1. ***Recovering philanthropic funds for future use.*** Unlike grants, mission investments return capital to a foundation. They augment its resources by "recycling" funds for additional rounds of philanthropic activity.
2. ***Achieving social benefits in ways that grants cannot.*** Mission investments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

Major Findings

Mission Investing Activity

- Mission investing has increased significantly in the past five years. Foundations of all sizes and types (private, community, and corporate) are now active participants.
- The majority of private foundations' mission investing has been concentrated in program-related investments (PRIs).
- The PRI programs of four large foundations (the Ford Foundation, the David and Lucile Packard Foundation, the John D. and Catherine T. MacArthur Foundation, and one anonymous foundation) together account for most historical US mission investment activity. In recent years, however, mission investing by smaller foundations has grown rapidly. Smaller foundations accounted for 44% of all new mission investment dollars in 2005, representing an annual growth rate of 22% over the past five years, compared to a 13% growth rate for the most active four foundations. The fastest growth in participation has been among foundations with assets under $200 million.

Number of Foundations Making Mission Investments



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

Mission Investment Structure and Performance

- The terms mission investment and PRI are used broadly to describe many types of investments. Our research disclosed 20 different asset classes that qualify as mission investments, all of which can be priced for either market or below-market returns. Among the foundations we researched, we found investments in 18 of these asset classes.
- Historically, foundations have concentrated their mission investments in low interest loans and loan guarantees to nonprofit organizations. Recent years, however, have seen increasing activity in other debt asset classes like insured deposits and loan funds, and in equity investments such as real estate and venture capital.
- Some 43% of foundations fund their mission investments exclusively from program funds, but nearly half have used endowment funds, either exclusively or in concert with program dollars.
- Although foundations have typically made direct investments, they are increasingly utilizing investment intermediaries such as community development financial institutions (banks, credit unions, loan funds, and venture capital funds).
- Foundations are also beginning to use more market-rate investments. In 2005, 11% of mission investments had market-rate expected financial returns, and over the past five years this segment has grown three times as rapidly as below market-rate investments. Here, too, smaller foundations are leading the way.

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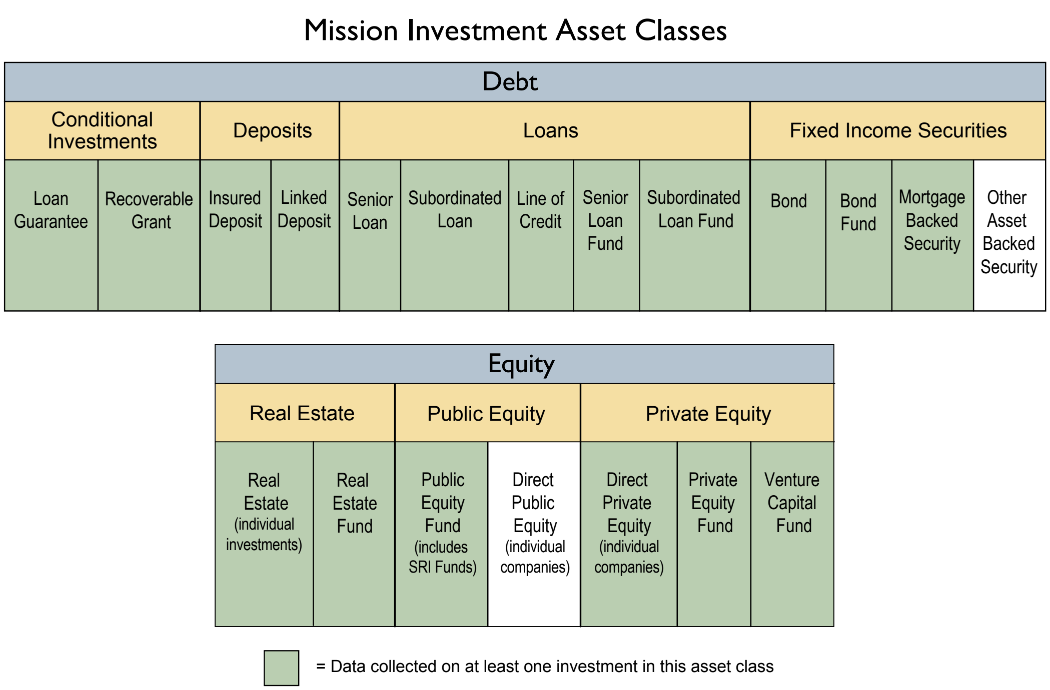
- Mission investments have focused on four issue areas: Economic Development, Housing, Education, and Environment. Together, these areas account for 85% of all mission investment dollars invested from 2001 to 2005. Investee types and asset classes vary widely by issue area.
- As the vast majority of completed mission investments are loans, meaningful financial performance data is only available for this asset class. Of the foundations that made loans over the past 40 years, 75% achieved a zero default rate.[3] At the other extreme, three foundations had cumulative default rates in excess of 30%, suggesting that they managed their portfolios differently from the rest. Excluding these three foundations, the overall repayment rate was 96%.

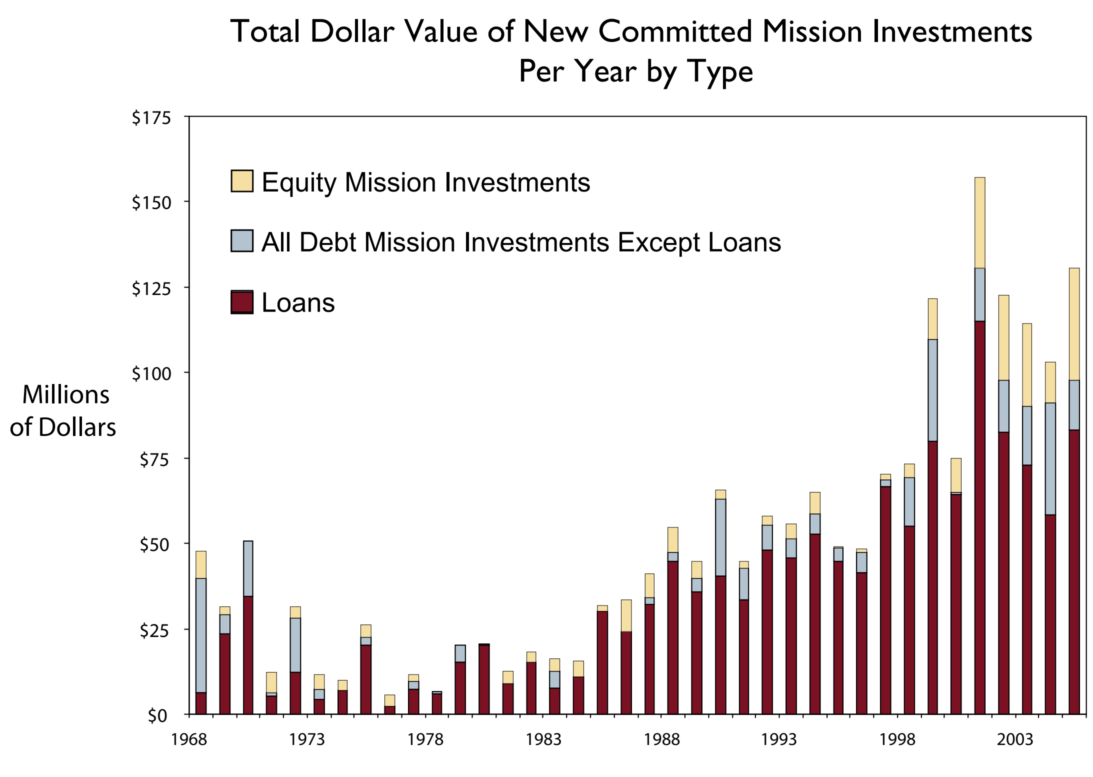


[3] "Zero default rate" means that all principal and interest was fully repaid. In cases where some portion of principal or interest was not fully repaid, many foundations were unable to report the amount of the default. Therefore, although we know the percent of loans that experienced some degree of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

Mission Investing Management

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

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



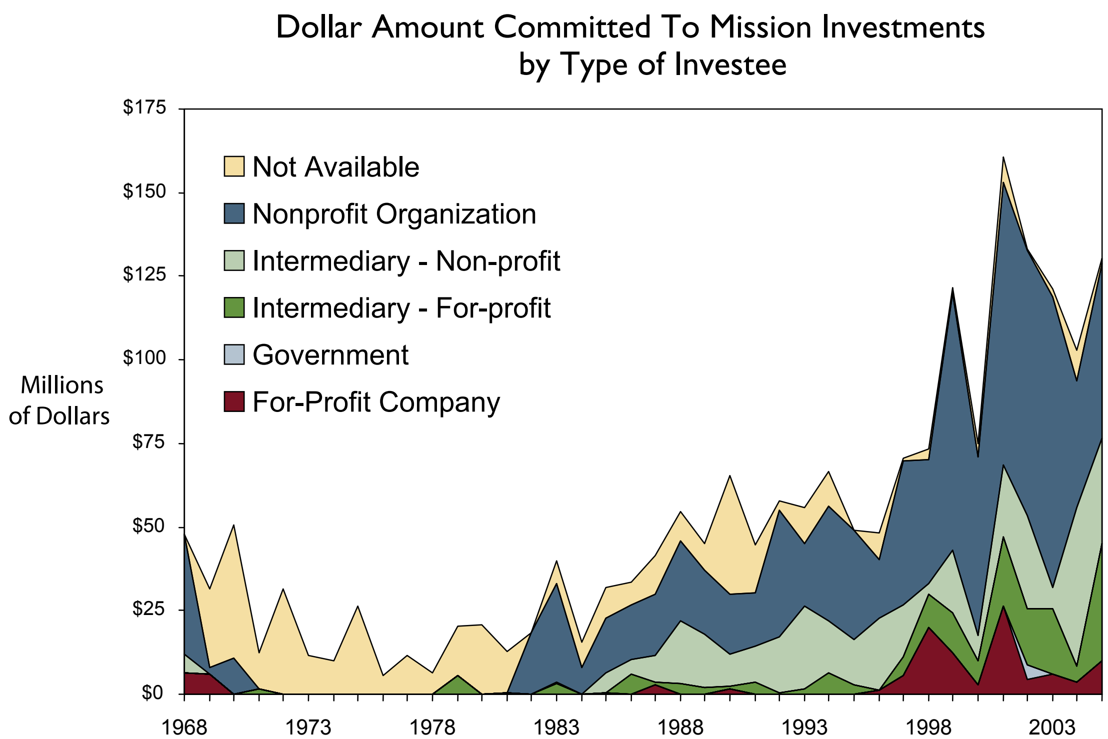
Notes: In constant 2005 dollars based on annual average CPI, all urban consumers as reported by the US Dept of Labor. 13% of all investments studied did not have available start dates or specified asset classes so these investments were not included in this analysis. To avoid skewing the trend data,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

Building on the Momentum

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

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

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



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REPORT INFORMATION:

For an electronic download of this executive summary or the full report, please visit **www.fsg-impact.org/app/content/actions/item/182**. You may also send an email request for the full report to **info@fsg-impact.org**.

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