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Expanding Philanthropy's Reach

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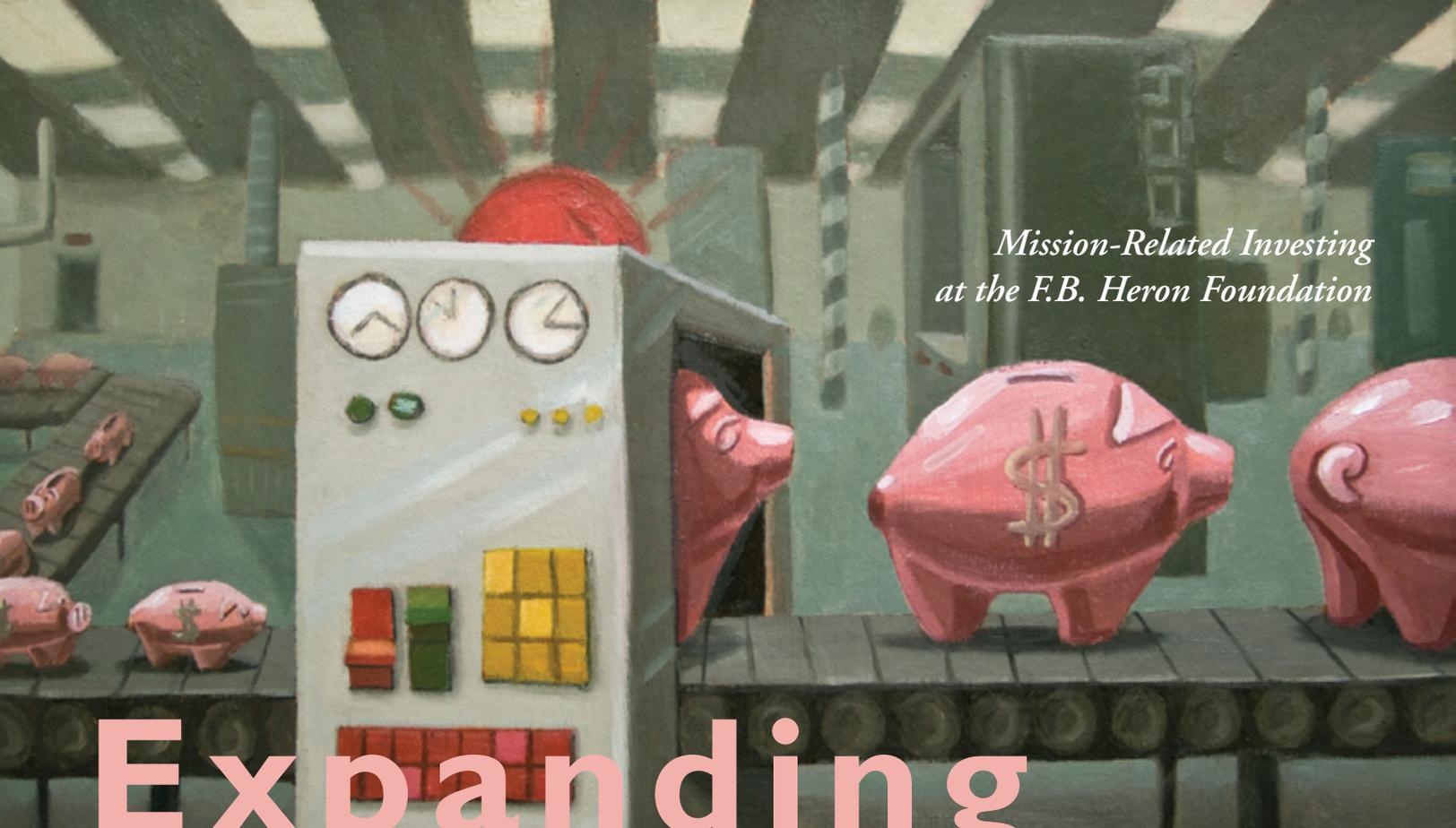


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*Mission-Related Investing
at the F.B. Heron Foundation*

Expanding Philanthropy's Reach

When New York's F.B. Heron Foundation, a private, grant-making institution, was created, it had a mandate to invest assets and donate 5 percent of returns annually to help low-income people and communities to help themselves.¹ The year was 1992, the cusp of one of the greatest economic booms in U.S. history. But as Heron's asset base swelled, 5 percent for community work began to look insufficient to help the many Americans who were missing out on the boom.

by Michael Swack
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In a 1996 meeting, directors realized they were spending too much time reviewing a particular investment manager's performance and too little time discussing Heron programs. It was time to reevaluate priorities. The foundation's social mission and tax-exempt status suggested that it should be more than a private investment company using excess cash for charitable purposes. It needed to be different from conventional investment managers.

Heron concluded that the 5 percent payout requirement was the narrowest expression of its philanthropic goals. The other 95 percent of assets, the *corpus*, could give the board the tools it needed for greater social impact. Staff members were encouraged to explore ways in which Heron could engage more of its assets through a combination of grants and mission-related investment strategies.² The foundation decided to leverage an increasing amount of its resources to pursue its mission and to maximize its impact in low-income communities.

The Road to Mission-Related Investing

Developing a mission-related investment strategy did not happen overnight. Heron spent considerable time refining its mission and determining how a proactive investment strategy could enhance it.

With initial uncertainty as to how far and fast the foundation could move, there was a reluctance to establish specific mission-related investment targets. So the foundation adopted an incremental approach. Staff members were encouraged to explore core-program opportunities that would build on existing networks and expertise—and to share lessons learned.

First Step

First Heron transferred some of its actively managed investments into index and enhanced index funds. The decision was based on widely accepted research unrelated to

mission investing that showed no substantial long-term advantage for active management in many core asset classes. The step reduced investment-management fees and allowed Heron to redirect its resources—away from managing dozens of investment managers and toward building a mission-related portfolio. Today the investment performance is as good as when the entire portfolio was actively managed.

Assembling the Skills

Asked for guidance in developing a mission-related investing strategy, Heron's investment consulting firm was deprecating, and the board began to realize how much its intentions challenged conventional thinking. So it built an internal management capacity for certain functions and encouraged staff to get training in financial analysis and the investment process. It also authorized a new position separate from the finance and administration functions—vice president of investments. Additionally, it conducted a search for an investment consulting firm that could relate to mission-related investing, and in 2004 it retained Evaluation Associates.

Learning from Others

Early on, Heron looked to other foundations and institutional investors (including commercial banks, insurers, and some public pension funds) for examples of alternative asset deployment. It learned about below-market investments, including program-related investments (PRIs).³ It also found willing partners among like-minded large commercial banks that sought to deliver both market-rate financial returns and positive social impact through “double-bottom-line” real estate and venture-oriented private equity funds.

Leveraging Relationships

Through partnerships with community-based organizations and financial intermediaries, Heron witnessed firsthand the

transformative power of investing in America's low-income communities—primarily through home ownership, enterprise development, and access to capital. Its grantee pool offered a natural place to look for opportunities to make below-market program-related investments, and its past knowledge of grantees' management and operational histories supported high-quality underwriting. It began making PRIs in 1997.

Market-Rate Opportunities

Heron's staff works to build a market-rate portfolio of mission-related investments in three primary ways:

- Conducting active outreach to identify opportunities within various asset classes,
- Adapting traditional investment vehicles and asset managers to mission goals, and
- Researching and developing new investment vehicles, such as the Community Investment Index, a screened, best-in-class methodology used to identify publicly traded companies with superior records of engagement with underserved communities.

Bridging the Program and Investment Functions

As its prospecting efforts turned into a pipeline of tangible deals, Heron began a conscious effort to bridge its program and investment units—a significant departure from how typical foundations are organized.

Although many program staff members appreciated the benefits of having access to a new philanthropic tool, others did not feel comfortable with the training, mentoring, and analysis that making PRIs demanded. The result was some staff turnover. In replacing staff who decided to leave, Heron looked for officers who felt comfortable with financial analysis and investing. It took time, but Heron now enjoys a collaborative model, with staff in the two functional areas working side by side.

Using Resources Effectively

To be successful in developing a mission-related investing strategy, a foundation must, of course, have board support. Although foundations' executive and professional staff may encourage boards to discuss mission-related investing, the transformative effects of the strategy depend on board commitment. Heron's success is closely tied to that factor.

Mission-Related Investment Continuum

To sort through the mission-related investing opportunities, Heron's staff developed the "Mission-Related Investment Continuum," which lays out asset classes available to mission-related investors. On the left side are below-market investments—grants and PRIs including private equity, senior

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loans (first claims on collateral), subordinated loans (second or "junior" claims on collateral), and cash. On the right side are mission-related investments that generate market rates of return (cash, fixed income, public equity, and private equity). The least risky investments are in the center of the Continuum; the risk level increases as you move toward both ends.

In developing the Continuum, Heron staff considered the central tenets of traditional investing discipline: asset allocation, performance benchmarking, and security or manager selection. Heron's asset-allocation policy—which is paramount to portfolio performance—has not changed to accommodate its mission-related investing prac-

tice. Rather, mission-related investing opportunities are considered within the overall asset-allocation framework of a well-diversified portfolio.

Heron also has identified appropriate performance benchmarks by asset class to evaluate relative performance and to compare both risk and return for its mission-related investments versus standard, capital-market measures. In choosing its mission-related investments, staff considers variables such as track record, investment strategy, and market opportunity.

Heron has taken advantage of mission-related investment opportunities across the Continuum. In some ways, its mission is particularly suited for such opportunities. Foundations that are active in fields where investment and lending are more limited may find it challenging to identify the same breadth of opportunities. Not all foundations will employ mission-related investing along the entire Continuum; one or two asset classes may be sufficient. In these cases, determining where to start depends on opportunities that are most consistent with mission and investment goals.

The Result

The result has been better than average portfolio performance. Contrary to the perception that there is a trade-off between financial return and social impact, Heron's experience during the last 10 years demonstrates that the objective of achieving competitive investment returns can be met even when incorporating mission-related investments into an overall portfolio and asset allocation.

As of December 31, 2006, Heron's total fund performance was in the second quartile of the Mellon All-Foundation Universe on both a trailing one-year and three-year basis, with 18 percent of assets in market-rate mission-related investments, 6 percent in below-market program-related investments (PRIs), and 3 percent in grants.

Today's mission-related investing environment is very different from the one in 1996. Now, there are mission-related investment vehicles in virtually every asset class. As Vice President of Investments Luther M. Ragin Jr. says, "While each foundation will have to work at visualizing its own mission through an investment strategy, there is no need to reinvent the wheel."

The F.B. Heron Foundation has moved well beyond the tipping point toward a fully diversified mission-related investing practice. Indeed, Heron continues today to expand its vision and investment horizons—using its broad experience in working with community-based organizations—to bring to bear on its mission the full weight of its resources and those of other investors. No longer does Heron view low-income people and neighborhoods merely as candidates for grants. It views them as good investments.

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Endnotes

¹ This article is excerpted from a case study by the School of Community Economic Development (SCED), Southern New Hampshire University, www.snhu.edu/ced. For the full study, see http://www.altrushare.com/apps/altrushare/Case_Study-MRI_Heron_Foundation2.pdf.

² 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." Unlike socially responsible investing, which focuses on social screening and proxy activity in public equities, mission-related investing is proactive. See "Compounding Impact: Mission Investing by U.S. Foundations" (FSG Social Impact Advisors: March 2007), <http://www.fsg-impact.org/app/content/ideas/item/485>.

³ Program-related investments (PRIs) are investments made by foundations to support charitable activities that involve the potential return of capital within an established time frame. See <http://foundationcenter.org/getstarted/faqs/html/pri.html>.

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