FOUNDATION NORTH
Te Kaitiaki Pūtea ō Tāmaki ō Tai Tokerau

Impact Investment

Part Two: Engaging in impact investing

Considerations for foundations as potential impact investors

Written by the Centre for Social Impact and the Ākina Foundation

CENTRE for SOCIAL IMPACT

ākina Growing Social Enterprise

Purpose

Foundation North commissioned this report in order to better understand the nature of impact investing, and the possibilities it provides to increase the reach of a foundation's impact.

The original report was prepared by the Centre for Social Impact and the Ākina Foundation in 2017. It has been packaged into two publications for the benefit of community organisations, social enterprises and businesses and foundations in New Zealand.

These reports explore:

Part one: An introduction to impact investing

- The nature and scope of impact investing
- Who and what impact investment can support

Part two: Engaging in impact investing

- Considerations for foundations in New Zealand thinking about impact investment
- Illustrative examples of strategies for impact investing by foundations

The reports will be most useful to community organisations, social enterprises and social businesses that are interested in finding out more about impact investment (Part One) and to community, family and other philanthropic foundations that would like to find out more about how to engage with impact investing (Part Two).

Contents

Summary

Part one: An introduction to impact investing

Impact investing refers to investments made into companies, organisations, assets and funds with the intention to generate a positive social or environmental impact alongside a financial return. While impact investing is a small sub-set of the investment sector, the term still represents a broad range of activity, for example:

A "finance-first" impact fund seeks to deliver market-rate returns for investors while investing in businesses in sectors that are looking at achieving social or environmental outcomes

An "impact-first" fund will provide loans to social service providers or community groups at a below-market rate because they are unable to access finance elsewhere.

The impact investing sector has grown into a significant market internationally. The development of the sector around the world has been driven by the recognition that philanthropic and public funds are insufficient to address the scale of social and environmental challenges facing the world today.

The social sector itself has been transforming in order to find new ways of addressing these challenges, including the rise of trading charities, social enterprises, social businesses and social service providers that are engaging differently with governments. This has created the opportunity for impact investing to serve as an additional tool for financing organisations that are having a social impact.

Members of the Global Impact Investing Network (GIIN), founded in 2009, are now reporting an aggregate US$114 billion in funds under management (FUM). Charitable trusts and foundations are significant contributors to the sector, with a 2012 study undertaken by GIIN showing that investments made by charitable trusts and foundations account for just under 50% of the overall impact investing market.

Internationally, and in New Zealand, philanthropic funders are engaging in impact investment in order to:

- provide access to capital for social impact organisations that cannot access sufficient capital from mainstream philanthropic grant programmes, or other investors
- provide access to capital for social impact organisations where philanthropic capital alone is not sufficient to meet capital requirements
- increase the range of organisations that have a social or environmental impact e.g. social businesses
- increase the range of financing options for both funders and social impact organisations e.g. loans, patient capital, equity, quasi-equity and guarantees
- participate in investment activities (as investor, funder or capacity builder) with other parties in order to unlock new capital that creates impact and furthers mission
- make the available capital go further by 'recycling' funds over time so that the capital can be used more than once
- increase the impact of capital investments under management (compared with mainstream commercial investments) where assets can make a significant difference if intentionally invested for impact with an expected 'market-rate' return

The opportunity for the philanthropic sector is to engage in or leverage the following types of financing:

- **Seed:** patient capital that supports innovation and development of social impact organisations
- **Growth:** investment to scale social sector activities that are proven to work
- **Working capital:** supporting social sector organisations to deliver on large-scale contracts by providing up-front capital in the form of a loan
- **Asset purchase:** providing loans to social sector organisations to purchase large-scale assets that further their ability to deliver on social outcomes. Loans, rather than equity, are preferred, given the not-for-profit nature of the sector.

For organisations in the social sector, new and additional sources of capital such as these will increase their ability to access capital at a level that goes beyond what is traditionally available through grant funding.

In New Zealand, over 50% of social sector income now comes from trading activities. Despite this income generation capacity, the sector is not yet able to address society's challenges sustainably and at a scale that is necessary to overcome them.

These trading activities, however, mean that social sector organisations have capacity to service investment, and these organisations are increasingly seeking to learn more about how they can access this type of funding. This has resulted in a number of parties beginning to build investment infrastructure including managed investment funds, social finance intermediaries and social impact bonds. This new activity is only starting to scratch the surface of the demand. Much more will be required in order to make investment an accessible and efficient option for social sector organisations.

Part two: Engaging in impact investing

Internationally, philanthropic sector impact investment makes up almost half of the impact investing market, and in New Zealand, a number of community trusts and family foundations already engage in mission-related investment.

This report seeks to give practical considerations for engaging in impact investment. Any trust or foundation must act within the bounds of the law and its governing documents. While this report does not seek to give legal advice it does provide an understanding of the relevant duties, and clarifies that "prudent" investment and the "fiduciary duty" do not always require the maximisation of return according to its risk profile for each individual investment. For example, an investment made for the purposes of furthering a foundation's charitable purposes or strategic programmes that provides a sub-market rate of return may still be prudent if there is careful consideration of the investment and how to offset this shortfall.

The report then sets some context for engaging in impact investing. It sets out the life stages of a trading enterprise and how investment is used to support its activities at each stage. It also explores the pros and cons of investing indirectly, through intermediaries, or directly into social impact organisations, including managing transaction costs, ensuring the right expertise is present, and the extent to which fit-for purpose support to social organisations can be achieved.

Finally, the report sets out some practical guidance on what to consider in determining if and how to engage in impact investment. Five illustrative strategies are provided that cater to different drivers for engaging in impact investment. These are presented for discussion and exploration of options to feed strategy development.

Should any organisation choose to pursue one or more of these options we would recommend that a more intensive strategy development and action planning process be carried out.

Part Two: Engaging in impact investing

Impact investing encompasses a broad range of activity. This section sets out the different ways an impact investment can be made and how foundations could incorporate these into their activities.

It will cover:

- Important context for foundations engaging in impact investing activity
- Considerations for investors that will inform the development of an impact investing strategy
- Examples of strategies for foundations

This section will provide important context for foundations to understand before they can start outlining their goals for an impact investing strategy, including:

- The legal framework foundations must operate in
- The general progression of trading activities from idea to scale and how social impact organisations use capital to support these different stages
- The types of investment that an impact investor can engage with – indirect, direct and catalytic investments

1. The Strategic Opportunity for Philanthropy

Impact investment is not a replacement for philanthropy; rather it is an additional tool that can maximise the impact of a foundation's corpus and expand the scope of its programmatic impact. Consideration of the impact of all of a foundation's assets is often described as a "Total Impact" approach[1]. This might include incorporating "finance-first" investments into a foundation's corpus investment strategy or engaging in "impact-first" investments through its programmatic strategy.

Strategic opportunities that impact investment provides to philanthropic actors include:

- Expanding capital resources directed towards mission without compromising sustainability by including impact investments in core investment strategy
- Leveraging capital into the social sector at a scale that would rarely be possible using grants (e.g. New Zealand Housing Foundation's $100 million fund raised to expand its reach)
- Growing the capability of social impact organisations so that they are better equipped to unlock investment from a variety of sources (e.g. the Ford Foundation identified that as it continues to offer programme-related investments, it is being asked to participate in deals of increasing complexity as borrowers become more sophisticated)[2]
- Creating shared pools of capital to scale solutions that work while recycling financial capital.

"Impact investing challenges the whole notion of philanthropy. It asks, 'what does it take to deploy capital in a way that is positive?' It is a huge opportunity to change the status quo."

Lisa Kleissner, KL Felicitas Foundation

1 How foundations are using Total Impact approaches to achieve their charitable missions, UK Government, 2014

2 Foundations and Social Investment: making money work harder in order to achieve more, Margaret Bolton, 2005.

International case studies

Strategy	Description
Expanding capital resources available to deliver mission	**McKinnon Family Foundation (Australia)** The McKinnon Family Foundation is a Private Ancillary Fund (PAF) established in 2006 by John and Sue McKinnon. The foundation's mission is focused around poverty alleviation, protection of the environment and development of social enterprises. In addition to making grants, the Foundation is committed to the responsible investment of its assets, with 10% percent of its corpus currently invested in impact investments and the ultimate goal of having 100% of its portfolio in impact investments.
Leveraging capital at scale into social problems	**Gates Foundation (Global)** The Global Health Investment Fund has been established to accelerate the development of drugs, vaccines and diagnostics for diseases that disproportionately affect developing countries through the provision of capital to products in the last stages of their clinical development. The Gates Foundation has substantially reduced the risk for investors by providing a first-loss guarantee and a risk share, thereafter. Without the Gates Foundation's commitment, this investment fund would not have been raised successfully.
Growing capability	**The Impact Investment Ready Discovery Grant (Australia)** The Impact Investment Ready Discovery Grant provides not-for-profit organisations with grants of up to AUS $50,000 to explore pathways towards financial sustainability and prepare for future impact investment through capacity building. The Discovery Grant, established by Philanthropy Australia in partnership with NAB (which has contributed matched funding of AUS $250,000) and funding partners: English Family Foundation, Rowley Trust, Snow Foundation, Vincent Fairfax Family Foundation, CAGES Foundation, Equity Trustees and Payce Foundation, aims to distribute AUS $500,000 in grant funding to grow the investment pipeline and support sustainability of the sector.
Scaling solutions and recycling capital	**Big Issue Invest (UK)** Big Issue Invest Social Enterprise Investment Fund LP was created in 2010 with an initial raise of £9.2 million. The fund provides growth capital to UK-based social enterprises with clear social missions, a sustainable business model and demonstrable social impact. It has received direct investment from a group of foundations, together with two banks and high net worth individuals. The Esmée Fairbairn Foundation was one of the fund's lead investors, which gave other investors the confidence to participate. The fund has so far made more than 21 investments with a total value of more than £7.5 million with an internal rate of return of around 10%.

2 The Context of Impact Investing

2.1 The legal framework for foundations

In New Zealand, the legal structure of a Foundation is generally a trust, of which there are numerous different types, including family trusts and community trusts. A New Zealand trust's investment and granting activities are governed by the following legal documents:

- The Trustee Act 1956
- The foundation's trust deed

In addition to this, certain types of trusts must comply with other relevant legislation, including the Charitable Trusts Act 1957 (which applies to charitable trusts), and the Community Trusts Act 1999 (which applies to community trusts). Together, the above sources impose a number of duties on the foundation's trustees.

Fundamentally, trustees must observe the terms of the trust deed. This is a paramount consideration, because it sets out the specific intentions behind the trust, and it may expand or narrow powers set out in the Act. In the discharge of all duties, trustees must act responsibly, with due diligence and prudence.

The following section provides context about the duties of trustees and how this relates to impact investment. It is not intended to provide legal advice. Foundations should consult their legal advisors before embarking on any new impact investing activity so that they have clear guidance on the specifics of their activities.

Trustees' duties in relation to investment are set out in the Trustees Act. Section 13A gives trustees very wide powers of investment, allowing them to invest any funds in any property. However, this is constrained by the duty to invest prudently, as reflected in section 13B. The Act defines the duty to invest prudently as "investing with the care, diligence and skill that a prudent person of business would exercise in managing the affairs of others". The essential requirements are that trustees: define the objectives of the trust, as provided in the trust deed and with regard to other surrounding circumstances; define the investment strategy based on the objectives of the trust; and, invest according to that strategy.

Additionally, trustees are required to have regard to the list of considerations set out in section 13E of the Act, which include the following:

- The desirability of diversifying trust investments
- The nature of existing trust investments and other trust property
- The need to maintain the real value of the capital or income of the trust
- The risk of capital loss or depreciation
- The potential for capital appreciation
- The likely income return
- The length of the term of the proposed investment
- The probable duration of the trust
- The marketability of the proposed investment during, and on the determination of, the term of the proposed investment
- The aggregate value of the trust estate
- The effect of the proposed investment in relation to the tax liability of the trust
- The likelihood of inflation affecting the value of the proposed investment or other trust property

Documentation must be sufficiently comprehensive to show the regard given to the above factors as well as the surrounding circumstances.

Common law duties, including the fiduciary duty to exercise powers for the best interests of all future and present beneficiaries, extend to both the power to invest and to the duty to apply funds for the benefit of the trust beneficiaries. As impact investing is a relatively new endeavour, there is a lack of clarity around the application of the duty to invest prudently in relation to impact investment, which encompasses both investment activity and the application of funds for the benefit of beneficiaries.

An important question that stems from these duties is whether trustees are required to maximise the financial return of each investment for present and future beneficiaries, or whether they may accept a lower than market-rate return for some individual investments in favour of a social return that benefits beneficiaries in lieu of maximising profits and then granting the proceeds. This might be achieved by:

- Dealing with impact investments only in the "granting" budget, being the budget that is allocated to grants;
- Preparing to offset any shortfall in market-rate return by setting aside a portion of the grant portfolio.

Trust accountants can advise on the most appropriate way to account for impact investment within foundations.

Relevant to this is the reform of the Trustee Act 1956 that has been proposed as part of the Trustee Amendment Bill. The Bill amends the matters that may be taken into consideration when exercising the power to invest to expressly include "the objectives of the trust or the permitted purpose of the trust". It is not clear how far this goes towards clarifying whether an investment can be made primarily for a purpose other than maintaining the real assets of the trust (i.e. as a tool for impact).

It is important to note that the test of prudence is judged by the manner in which an investment strategy is conducted, rather than the results that are achieved. Additionally, it is important to recognise that trustees are not "insurers" of the funds for which they are responsible – loss of trust money, or diminution in the real value of the trust fund does not in itself render a trustee liable. For liability to be attributed, there must have been a breach of trust.

If trustees carefully, and with professional advice, undertake impact investments with below market-rate returns and take reasonable steps to ensure that this does not diminish the real value of the trust's assets in perpetuity, it is unlikely that there would be a breach of trust.

If the trustees seek additional comfort, given that the obligations set out in the trust deed are paramount, the trustees may wish to amend the trust deed to explicitly allow the trust to invest in social impact organisations that advance the Trust purpose, and therefore may return a lower than market-rate return. This would clarify the trustees' right to invest in below market-rate investments to further their charitable purpose or programmatic goals, but does not remove the requirement to take reasonable steps to maintain the real value of the trust assets in perpetuity.

If there is any uncertainty with respect to an investment or programme, trustees should seek legal advice. The purpose of this section is to give an overview of trustees' duties and to address the common misconception that fiduciary duties necessitate profit maximisation in all investment activities. Again, foundations should consult their legal advisors before embarking on any new impact investing activity so that they have clear guidance on the specifics of their activities.

2.2 The life stages of trading social impact organisations

The table below presents the “life stages” of an organisation and investment needs at each stage. This is presented as a linear process for the purposes of creating a common understanding about typical capital and capacity needs. However, in reality this is rarely a straight-line journey and the activities at different life stages might be happening simultaneously. Organisations may take a considerable period of time in each phase, especially the idea/innovation stage which requires significant iterations in order to produce something that is worthy of scaling.

Life stages and investment needs of social impact organisations

Life Stage	Idea/Innovation	Grow/Scale	Established
Activity	- Explore and refine the idea - Put together initial resources and infrastructure for activities - Test the idea by taking it to the market - Refine the idea based on learnings from testing	- Further refine idea, creating efficiencies - Develop strategy to take refined idea to scale	- Organisation has track record of trading and creating impact - May continue
Funding requirements	**Grants or patient capital:** - Seed funding to explore and test ideas - Funding to access professional support	**Patient capital:** - Growth capital to implement growth strategy - Funding to access professional support	**Working capital:** - Capital to even out cash flows - Capital to prepare to deliver on new contract
Organisational capacity support	- Business modelling - Impact modelling - Financial modelling - Customer engagement strategies	- Business growth strategy - Operational growth strategy - Financial projections	- Majority of capacity is likely to be in-house by now - Professional services (e.g. lawyers and accounting firms) used to support business activities
Investment readiness capacity support	- Capital strategy - Design and drafting of investment deal - Investor engagement	- As for Idea/Innovation stage, but with a focus on a different type of investment and investor	- As for organisational capacity support above. Level of support required from professional services will depend on the complexity of the capital raise

2.3 Building capability and supporting innovation

Supporting innovation and capacity in the sector is a key lever for introducing more capital into the sector. Funding focused on these activities ensures that organisations can build solutions that work and business models that can provide for sustainability or take on investment. Set out below are some examples of how grants can be applied to build a base of organisations that create sustainable impact and could take on investment to grow that impact.

1. Seeding innovation

Description	International example(s)	New Zealand example(s)
To grow the number of innovations that may have significant impact. Fund research and development or provide income for individuals so that they can experiment and test new approaches and business models for underserved markets and communities.	Global Innovation Fund - a unique hybrid investment fund that supports the piloting, rigorous testing, and scaling of innovations targeted at improving the lives of the poorest people in developing countries. Grant, loan and equity funding from $50,000 to $15 million .	Foundation North's G.I.F.T (Gulf Innovation Fund Together) fund. Foundation North's new innovation strategy (seed, scale, system).

2. Market-building activity

Description	International example(s)	New Zealand example(s)
To grow the number of investors and investments made in the region. Fund activities that grow the market for impact investment. These may include building the capacity of fund managers, bridging information gaps and improving impact measurement.	UK Department for International Development's 13-year Impact Programme carries out market-building activities that seek to reduce the constraints in the impact investing value chain and make the practice of impact investing as effective, as efficient and as attractive as possible to investors, intermediaries and enterprises.	The Macquarie Group Foundation and Macquarie Capital (NZ) partnered with Ākina Foundation to support the growth of the impact investment market in New Zealand in 2015. They have carried out awareness raising and brokering activities.

3. Organisational capacity building

Description	International example(s)	New Zealand example(s)
To grow the number of not-for-profits, social enterprises and businesses that have strong business models. Support organisations to access professional support to achieve efficient and effective trading activities that can sustain the organisation and, if necessary, service investment.	UK Department for International Development's 13-year Impact Programme carries out market-building activities that seek to reduce the constraints in the impact investing value chain and make the practice of impact investing as effective, as efficient and as attractive as possible to investors, intermediaries and enterprises.	The Macquarie Group Foundation and Macquarie Capital (NZ) partnered with Ākina Foundation to support the growth of the impact investment market in New Zealand in 2015. They have carried out awareness raising and brokering activities.

4. Investment readiness

Description	International example(s)	New Zealand example(s)
To grow the number of organisations that successfully obtain impact investment. Support mission-led organisations to be in a position to raise investment capital. Investment Readiness Grants focus specifically on access to professional support to structure and communicate an investment proposition to investors.	The UK Cabinet Office established a fund, managed by Social Investment Business, to pay for investment and contract readiness support. £13.2 million was distributed to 155 ventures (with an average grant of £85,000) to help them grow and increase their impact. This unlocked £233 million in investments (£79 million) and contracts (£154 million) for charities and social enterprises[4].	The Tindall Foundation established an investment readiness fund, managed by Ākina Foundation, to provide social enterprises and mission-driven organisations with grants of $5,000-$10,000 for support from professional services to secure investment.

4 Source: In Pursuit of Readiness: Evaluation of the Investment and Contract Readiness Fund (2015) http://www.sibgroup.org.uk/sites/default/files/files/ICRF%20Evaluation.pdf

As demonstrated above, existing providers of these types of grants are limited and serve small segments of the market. Most social impact organisations have to use traditional grant funding creatively for these purposes but many are unable to access the resources at all.

CREATING SOCIAL IMPACT: INNOVATION PLUS SCALING

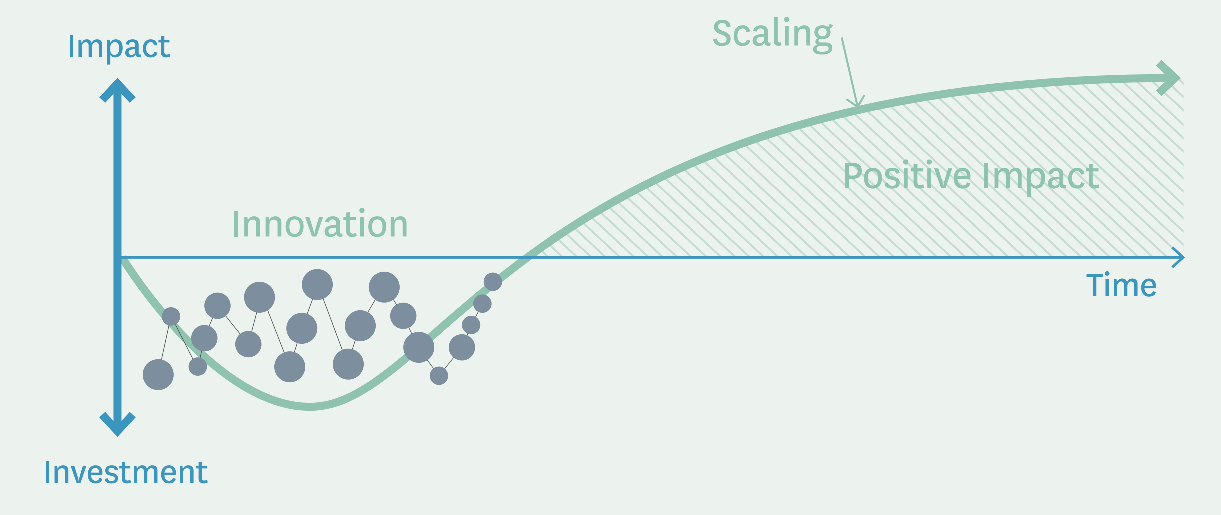


Figure 1: Scaled approaches require investment in innovation[5]

5 *Innovation and Scaling for Impact: How effective Social Enterprises Do It. Seelos and Mair, Stanford University Press, 2017*

2.4 Impact measurement and impact investment

Impact measurement has long been the domain of the public and non-profit sectors. Foundations that adopt impact investing activity need not necessarily learn new ways of measuring impact – their existing approach may work well and make understanding their overall impact easier by being able to integrate their data and reporting easily with their other programmes.

It is common practice in impact investing to approach measurement by reviewing a theory of change or logic model and selecting some key indicators of success. This simple and bespoke approach is considered a highly effective means of understanding the impact of an investment.

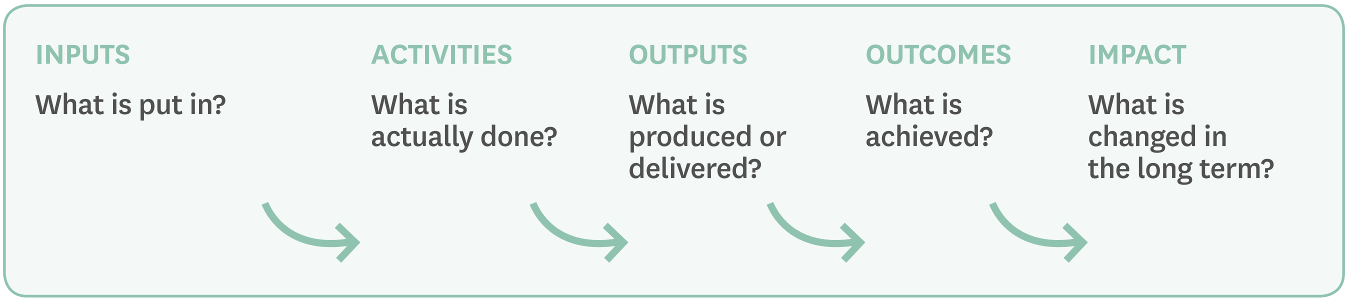


Figure 2: High level logic model framework[6]

Many methodologies have arisen alongside the growth of the impact investing sector. The most prominent tool to be developed is the IRIS (Impact Reporting and Investment Standards) catalogue.

This is a catalogue of metrics based on international best practice in a variety of sectors. The tool is best used to measure the social or environmental impact of social impact organisations directly or collectively through a fund, but is not suited for all types of investment or intermediary. Many of the measurement methodologies are suited for large scale projects or funds and require considerable resources to implement and administer. There should be a clear need for a formal measurement methodology before committing resources to it.

Measuring quantitative impact may sometimes be too costly, especially if you are focused on finance-first impact investments. In this case, subjectively knowing that the investment provides some form of social and environmental impact can be sufficient to proceed with the investment. This is often commonly accepted for investment funds that invest in thematic areas, such as clean-tech, care of aging people and waste management or where the investor has specialised domain expertise in a particular area of impact.

6 Field Guide to Impact Investing for Australian Charitable Trusts and Foundations, Social Impact Hub, 2015.

3. Impact Investing Specific Risks

The risks associated with impact investing are largely the same as any other type of investment. Whether or not an investment offers a "risk adjusted" rate of return does not affect the nature of the risks. Set out below are the risks that are unique to, or more pronounced in, impact investments.

Liquidity risk

This refers to the inability of investments to be sold when the capital is required. As the market is less developed, it is acknowledged that there is less liquidity in the impact investing market. In theory, a charitable trust should be able to wait out the full length of an investment instrument as long as the foundation is generating sufficient income each year to distribute its grants. Being part of a larger portfolio with more liquid assets also mitigates this risk. This risk needs to be considered in the context of a foundation's entire portfolio.

Impact risk

This is the risk that the investment will not create the impact it set out to. This risk is less pronounced when there has been no trade-off on the financial return in deference to the impact.

Assessment of this risk will require a different skill set from that of the average investment manager. With respect to investing through intermediaries, this risk is assessed on the basis of the skill and experience of the team that will manage the funds. With respect to direct investments into social impact organisations, this is a skill set that will likely already be present amongst foundation staff.

Reputational risk

Reputational risk arises when an investment is not performing and a foundation needs to take steps to recoup its investment. Putting a social impact organisation into liquidation or enforcing a security interest over its premises may not be looked upon favourably by the public and has led foundations to write off loans in order to avoid this risk.

Manager risk

Relating to the above risk, where an impact investing portfolio is being managed by a person or entity with significant financial experience, but not impact investing experience, there is a risk that a fund manager will show unconscious bias against impact investment or may even be resistant to it because it is outside business as usual. This can be a significant barrier to implementing an impact investing strategy in a portfolio.

4. Ways to Engage in Impact Investing

4.1 Managed funds

A managed fund can be a relatively passive means of investment when compared to direct investment (explored below), whereby a number of investors pool their money which is then managed by a professional investment manager in accordance with a disclosed investment strategy. Note that managed funds range in the level of involvement from investors. A foundation may choose to be an active investor, for example, where it is the lead investor providing seed capital in a new fund.

Benefits

- The pooled capital approach minimises the transaction costs required for each individual deal by spreading them across multiple investors. These costs include sourcing deal flow, undertaking due diligence and ongoing performance reviews of the portfolio.
- Finance-first impact funds - many funds focus on creating impact while providing a commercial market-rate return. These funds have been shown to have a financial performance broadly equal to their commercial counterparts[7]. Some subsets of these funds have continuously outperformed comparable commercial funds[8]. Such funds could be additive to a foundations corpus portfolio in terms of both diversification and returns.
- Impact-first funds – other funds focus primarily on maximising impact. The terms of the investment will not reflect commercial deals but will instead be designed to meet the needs of the social impact organisation. These funds are an efficient way for foundations to further their charitable purposes and programmatic goals through investment.

Risks or downsides

- As with all investment, there is a risk that the fund will not achieve its targets. The assessment of this risk is based on the capability and track record of the fund manager and the types of investments the fund intends to make.
- The more passive the investment and the more other parties that are involved, the less autonomy the foundation has over the investment process. This provides less opportunity to ensure investments are directly aligned with a foundation's purposes or to ensure that ongoing management of investments and their performance is in line with a foundation's best practice.

Examples

- The Giant Leap Fund is an Australian impact investing fund that invests in social businesses with high growth potential that are solving problems relating to the following themes: empowering vulnerable people, sustainable living and health and wellbeing.
- The fund favours investments in BCorps, as this means the organisation has previously been screened for social, environmental and governance performance.
- Root Capital is a non-profit investment fund that provides carefully designed loans to farmers in poor rural areas to grow their farming business, increase their income and employ more people in their community.

7 Introducing the Impact Investing Benchmark, Cambridge associates and Global Impact Investing Network, 2015

8 Introducing the Impact Investing Benchmark, Cambridge associates and Global Impact Investing Network, 2015. The Impact Investing Benchmark survey showed that over the period of 1998-2010 impact funds of less than or equal to $100 million returned a pooled IRR of 9.5%, outperforming similar sized funds in the comparative commercial universe, which returned 4.5% over this period.

4.2 Community Development Finance Institutions (CDFIs) and Social Investment Finance Intermediaries (SIDIs)

CDFIs and SIFIs are specialist financial service providers of affordable loans and support to businesses, social impact organisations and individuals who struggle to get finance from high street banks and loan companies.

Benefits

- The use of an intermediary minimises transaction costs for investors.
- The specialised support provided by these organisations is tailored to the needs of the social impact organisation.

Risks or downsides

- These organisations often serve the sector as a whole, which means a foundation cannot align this investment directly with specific programmatic goals.

Examples

- Good Shepherd New Zealand and Ngā Tangata Microfinance Trust both provide low or no-interest loans to individuals who are unable to access mainstream finance.

CASE STUDY

The Tindall Foundation provides multiple loans to the New Zealand Housing Foundation (NZHF) (2007)

Social impact organisation	NZHF is a not-for-profit, charitable trust set up to support and grow the community housing sector and provide affordable housing for low income households. The organisation is focused on developing communities and growing strong, safe neighbourhoods.
Use of investment	Loan finance from The Tindall Foundation enabled NZHF to build new social housing developments.
Investment	A number of loans were made to NZHF which were secured against the property developments. These security interests were transferred to the mortgage holder when the property was sold to a householder and the foundation was repaid.
Deal identification	Investment opportunities are most frequently identified through grant applications.
Deal assessment	Initially carried out by Prometheus* Finance which developed a report that was reviewed by the foundation's board. Post-Prometheus the assessment has been completed by foundation staff, trustees and legal consultants.
Decision making	Made by the foundation's board of trustees.
Monitoring	Initially carried out by Prometheus Finance. Post-Prometheus, monitoring has been done by foundation staff and an external debt-management agency - RML Ltd.

*Prometheus Finance was a social investment finance intermediary that provided loans to social and community organisations that were excluded from mainstream financial services. Unfortunately, it was subject to the same regulations as a New Zealand bank.

The regulatory burden increased dramatically after the global financial crisis and made operating at the scale of Prometheus unviable.

4.3 Social Impact Bonds (SIBs) and other results-based contracting mechanisms

A social impact bond, from the investor's perspective, is an investment into an intermediary that is tasked with achieving specified social outcomes and provides returns to investors based on the success in achieving those outcomes.

Benefits

- As with managed funds, pooling capital that is then managed by a professional intermediary minimises transaction costs for investors.
- Investors are able to align themselves with very specific, pre-determined outcomes.
- This approach supports innovation in social services with the intention of improving outcomes for vulnerable people.

Risks or downsides

- The inherent risk with investments that they will not reach their targeted financial return.
- The outcomes purchaser is often government. With three-year election cycles in New Zealand, relying on long-term outcomes contracts with government can be risky.

Examples

- The Peterborough Prison social impact bond was the first of its kind and reported impressive outcomes. The approach was then adopted by the UK Government and rolled out nationally which caused difficulties in measuring its outcomes against a control group and highlighted the risks of working with government. Despite this, the final results showed that the SIB had hit its targets and investors were repaid in full with a 3% p.a. return[9].
- Since the Peterborough SIB over 80 SIBs have been launched in many other countries, including those where outcomes have been purchased by non-governmental organisations, such as insurance companies[10] and charitable foundations[11].
- In February of this year, the New Zealand government launched its first social impact bond focusing on employing people in South Auckland with medium-level mental health issues.

9 Social Finance UK http://www.socialfinance.org.uk/resources/press-releases/>

10 Impact Bond Database, Social Finance UK, <www.socialfinance.org.uk/database/>

11 Impact Bond Database, Social Finance UK, <www.socialfinance.org.uk/database/>

4.4 Direct investment

This involves dealing with investment opportunities directly. It requires an entity to manage its own pipeline, due diligence costs, and ongoing performance management for each individual investment. It might involve being a sole investor or co-investing alongside other entities, but the investors themselves are driving the deal.

Benefits

- The investor has absolute autonomy over the parameters of its portfolio and the process that is undertaken for determining whether investments are appropriate.
- An ongoing relationship with investee organisations allows the investor to provide support and guidance and help organisations drive success. When investments are performing badly, engaged investors can be instrumental in turning things around. The investor also has absolute autonomy on when to pull the plug on an investment.

Risks or downsides

- Comparatively resource intensive
- Requires specialised capabilities and governance
- Harder to diversify a portfolio for the purposes of investment risk management.

Examples

- Bay Trust, Southland Community Trust, the Rata Foundation and the Tindall Foundation have all invested directly into community organisations providing low-interest, long-term loans.

CASE STUDY

Rātā Foundation invests $1.2m into Community Housing Trust (2015)

Social impact organisation	Community Housing Trust is a charity providing affordable housing for sale.
Use of investment	The loan facility allowed Community Housing Trust to facilitate the relocation of six houses from Christchurch's Residential Red Zone (which was being cleared of housing following the Canterbury earthquakes). The relocated houses were renovated and made available as affordable housing for families. The investment was initially used to support the redevelopment of the six red-zoned houses, and has been varied to allow for expansion of the project, to enable the building of new homes.
Investment	A revolving credit agreement for $1.2 million was put in place for three years, at an interest rate of 6.5% reducing to 5%.
Deal identification	Community Housing Trust presented the investment opportunity to Rātā Foundation under its community loans programme. The community loans programme enables community organisations to access capital for asset purchase, at fair rates. Rātā Foundation has a trusted reputation and is open to looking at deals flexibly and structuring to support the needs of both parties.
Deal assessment	The assessment of the proposal and the arrangement of the revolving credit facility were negotiated by the CFO to ensure that they best met the needs of the project and its ongoing expansion, and managed the risk of the investment.
Decision making	Made by the foundation board.
Monitoring	Monitoring of draw-down and payments by the finance department. Regular progress updates on the delivery of affordable housing are also provided.

CASE STUDY

Bill & Melinda Gates Foundation Mission Related Investment team

The Bill & Melinda Gates Foundation has put together a market-leading Mission Related Investment team that invests in and provides valuable advisory support to impact funds, community development finance initiatives (CDFIs), and social impact organisations.

Figure 3: The Gates Foundation approach to mission related investments[12]

Gates Foundation Process

Step One

Determine whether there were activities that had charitable value but no commercial rationale. These are funded with grant capital from the program team's budget.

Step Two

Determine the expected loss from the investment capital by focusing on the terms of the investment and the investee's potential to achieve financial sustainability and scale, the uncertainty of operating in the chosen market, and the exit opportunities. This expected loss is the Risk Share that is allocated to the program team's budget.

Step Two

If the program team determines that its total grant budget contribution (any grant funding plus the Risk Share) is likely to result in better charitable outcomes than other opportunities, the program team recommends the investment. If not, the investment team seeks to renegotiate commercial terms to lower the expected loss to the point at which the PRI would be worthwhile.

$15 Million bKash Case

Step One

The program team determined that $4 million of proposed activities should be grant funded and was prepared to make this grant from its budget. The remaining $11 million was evaluated as a potential PRI.

Step Two

The PRI team determined that the expected loss on the investment was 50 percent of invested capital, and the Financial Services for the Poor team was allocated $5.5 million of Risk Share.

Step Three

The FSP team determined that the opportunity to scale up financial inclusion in Bangladesh through an investment in bKash was worth the $9.5 million total contribution from its grant budget. This endorsement was combined with a recommendation by the Investment Committee and division president as well as the legal opinion that codified and ensured the charitability of the entire $15 million total grant and PRI support to bKash.

12 Making Markets Work for the Poor: How the Bill & Melinda Gates Foundation Uses Program-Related Investments, Stanford Social Innovation Review, 2016.

4.5 Investment clubs

Investment clubs are groups of individuals or bodies corporate that share deal flow, due diligence and investment performance management resources. Unlike a managed fund, it is the investor members of the club that make the ultimate decision on whether to invest in each individual deal, albeit within a collective approach where the deal terms may be driven by another party acting as lead investor.

Benefits

- The pooling of resources minimises transaction costs
- Investors are still able to be selective about their portfolio and only invest in deals that align with their impact goals
- The active engagement with other like-minded investors rapidly increases the experience and capabilities in the individual member organisations.

Risks or downsides

- The inherent risk in investments that capital will not be returned.
- The organisation needs to have a representative engaged in investment decisions – there is resource involved in employing this person/people and developing capabilities and strategies within the team.
- Requires a community of like-minded investors and resource to be put into initiating the club.

Examples

- Toniic is an international membership-based organisation that consists of individuals, corporates and foundations that share deal flow, due diligence and learnings related to investing in impact investments.

4.6 Catalytic investment

Internationally, philanthropic organisations have been leading the way in finding innovative ways to enable social impact organisations to access investment. Below are some examples of innovative funding mechanisms that have allowed social services or interventions to scale.

Guarantees

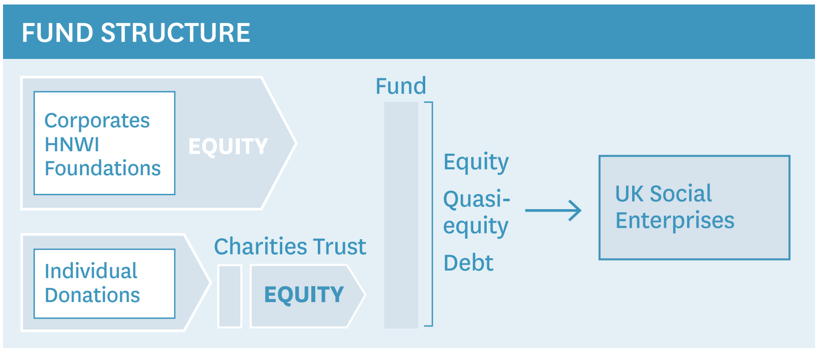
Guarantees are an enabling credit-enhancement tool that reduce the risks associated with lending and therefore reduce barriers and the cost of capital for borrowing organisations taking on investment.

Co-mingling

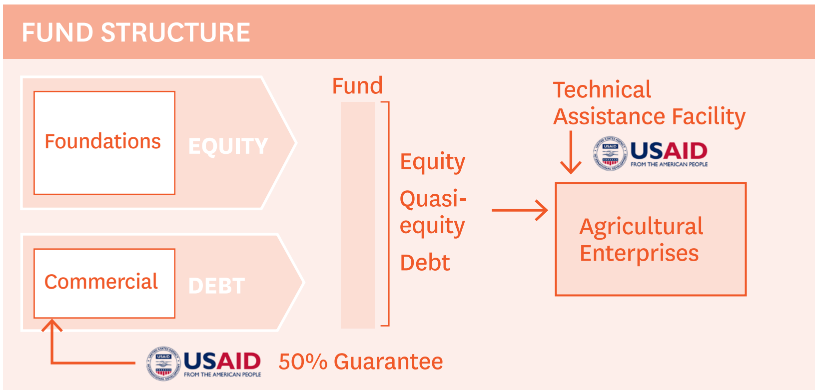
This term represents a range of increasingly sophisticated ways that philanthropic organisations are participating in partnerships to unlock greater public and private sector investment into a deal.

The deal will typically be structured in one of three ways:[13]

All investors invest on the same terms. In this case, a foundation might act as a lead or cornerstone investor, which encourages commercial investors to participate.



Foundations, with a focus on achieving social outcomes will provide risk capital, taking on more of the risk, but also taking higher return expectations. Removing some level of risk may make it more palatable for commercial investors to participate.



Foundations take a higher level of risk and a smaller portion of the return on the grounds that commercial investors would not be able to participate without a subordinated investor accepting sub-market rate returns.

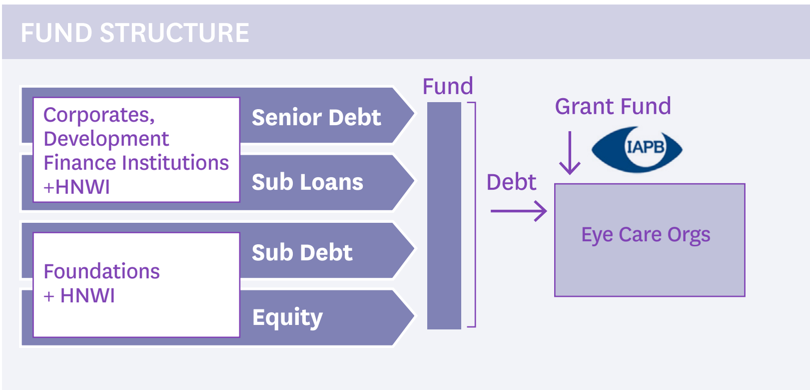


Figure 4: Examples of co-mingling deal structures

13 Examples taken from Achieving social impact at scale: case studies of seven pioneering co-mingling social investment funds, UK Cabinet Office, 2013.

5. Strategy Development Questions

As discussed, there is a wide range of motives and methods for impact investing. Each individual investor needs to consider their intentions and expectations related to risk, financial return and impact. The following are important questions when considering whether, and how, to engage in impact investment:

1. What is the appetite for risk of capital?[14]

- High – you want to invest in innovation and understand that this means supporting unproven ideas that are inherently riskier
- Medium – you want to help scale proven solutions and trading activities
- Low - you only want to invest in proven solutions from well-established businesses or in asset-backed/secured investments.

2. What is the need for or expectation of financial return?

- You need to generate funds for granting programmes so returns must be market rate
- You need to make enough return to cover the costs of the programme
- The financial returns are not important; your only goal is to provide the best source of capital to social impact organisations.

3. Is this aligned with an existing funding strategy or does it have a distinct strategy?

- You would like your capital to have a positive impact but this does not need to be aligned with your programmatic strategy
- You want to add an alternative type of funding to your existing funding strategy, priorities and programmes
- You want to achieve specific outcomes with a separate impact investing programme.

4. What is the expectation about measuring and monitoring impact? To what extent is measurement a part of the investment agreement?

- You want to understand how an organisation is making change in the world in order to decide where you put your money but you don't need progress updates beyond financial performance.
- Specific outcomes are why you invest and you want to measure how successfully your investment has been at achieving them.

5. Does the organisation have, or want to have, the capacity to carry out due diligence or deal creation in-house or wish to have this managed externally?

- Do you want an internal team to manage the impact investing activities?
- Do you want to make the ultimate investment decisions but have external advisors assess the viability of the deal for you?
- Do you want to outsource the activities so that an external party manages the impact investing component of your investment portfolio?

6. What is an acceptable cost to make the deal? Innovative types of finance agreement require additional investment to build investment readiness on both sides and create new terms.

- Do you need to minimise the transaction costs of your investments (e.g. by investing through an intermediary or specialising in specific types of transactions)?
- Is the transaction cost a necessary part of your intervention, recognising that new types of finance require innovation and not many people are incentivised to operate in this space due to the higher transaction costs?

7. What control do you require over decision-making about which organisations and types of investment are acceptable? Is it acceptable to have funds managed by a third party?

- You want your investment strategy and decisions to be managed internally
- You can invest in an aligned intermediary or can give sufficient instruction to an intermediary to get the outcomes you want.

8 What is the expectation about the relationship with the investee?

- You want to build a relationship with investee organisations and allow them to leverage your connections and expertise and to build your own capacity
- You want to be removed from the investing process.

14 Note that this refers to the risk of an impact investing portfolio, which must be taken in the context of the corpus portfolio as a whole.

6. Example Strategies

This section sets out example strategies that a foundation could implement to include impact investments into its investment portfolio or its programmatic toolbox. One or more of these strategies could be implemented simultaneously and it is not an exclusive list of strategies that are available. These are presented as options for discussion to test intent and approach rather than recommended action. A short description of each is outlined below followed by a more in-depth analysis.

1. Impact investment aligned with investment strategy

Intent
Make positive social and environmental impact with investments without sacrificing financial return.

How
Instruct fund managers to allocate a percentage of the investment portfolio into international or domestic managed impact investment funds that meet financial return expectations that align with "sustainable investment strategies to preserve and grow capital" (e.g. Bridges Fund Management's Growth Business or Property Funds in the UK and US, or the Small Giants Fund in Australia).

2. Pro-active impact investment in target communities

Intent
Support target communities by providing access to affordable finance to people and organisations that cannot access mainstream finance.

How
Invest in a community development or social finance intermediary that creates impact in target communities.

3. Responsive impact investment: respond to 'mixed-motive' opportunities that are led by external parties

Intent
Respond to investment opportunities brought by third parties that align with programme strategy or priority issues, or test new approaches that may enhance impact at a systems level.

How
Allocate a percentage of corpus assets to be made available from time to time to invest in third party driven opportunities (e.g. managed funds or SIBs) in response to unsolicited opportunities.

4. Pro-active impact investment: generating 'impact-first' opportunities (with or without intermediary)

Intent
Invest in organisations that deliver impact in line with programme strategy and priority issues in order to grow the capital available to impact organisations in Auckland and Northland.

How
Create an impact investment "carve-out" fund. Work with an intermediary to build a pipeline of potential investments or build internal capacity to pro-actively identify and assess opportunities.

5. Support impact investment infrastructure

Intent
Support the growth of quality investment opportunities by supporting innovation, investment readiness and infrastructure to create an efficient support system for social impact organisations.

How
Support impact investment development with or without investing directly. This may include activities necessary for organisations to prepare for impact investment from other investors e.g. funding investment due diligence (as with the SIB), providing guarantees to lenders, or funding intermediaries that carry out investment readiness programmes.

1. Impact investment aligned with investment strategy

Intent

Make positive social and environmental impact with investments without sacrificing financial return.

How

Instruct fund managers to allocate a percentage of the investment portfolio into international or domestic managed impact investment funds that meet financial return expectations that align with "sustainable investment strategies to preserve and grow capital" (e.g. Bridges Fund Management's Growth Business or Property Funds in the UK and US, or the Small Giants Fund in Australia).

The intent of this strategy is to maximise the positive social and environmental impact of the investments without sacrificing financial return. A foundation would continue to employ sustainable investment strategies to preserve and grow capital for this portion of its portfolio. It would maximise the social value of this investment by investing a proportion of the corpus in impact investments that meet the commercial risk and return ratio that is equivalent to current investing activity.

Most of the relevant managed funds are likely to be international as the domestic market is not mature enough to support multiple competing funds. Examples of sectors these funds invest in are education, health care, emerging markets and financial inclusion. These investments would not necessarily be aligned with programmatic strategies, but would be about making a positive impact more generally. They would form part of the overall investment strategy and would be viewed as an additional means of diversifying the portfolio throughout asset classes and contributing to global impact.

Opportunities to invest for market-rate returns will become available in New Zealand as the market matures, but these have less of a track record and would not provide the scale of opportunity that international funds could offer.

Financial return	Commercial rates of return (i.e. each individual deal has a risk-adjusted expected return)
Strategy	Not aligned with programme strategy. Aligned with investment strategy.
Impact measurement	High level reported by managed funds.
Deal creation and assessment	The foundation's fund manager carries out assessment of investment funds or other similar investment opportunities.
Cost	No additional cost unless the fund manager charges more for including impact investments in the portfolio.
Decision making	The fund manager decides where to invest funds within the scope of instructions set out in the SIPO.
Investee relationship	There will be no relationship with investee organisations.

Pros

- "Finance-first" funds are available internationally that demonstrate good commercial return.

Cons

- Although this would create greater social and environmental impact with investments it is not likely to directly progress priority outcomes for a foundation.

2. Pro-active investment in target communities

Intent

Support target communities by providing access to affordable finance to people and organisations that cannot access mainstream finance.

How

Invest in a community development or social finance intermediary that creates impact in target communities.

The intent of this strategy is to generate impact in target communities by providing access to affordable finance to people and organisations that cannot access mainstream finance. Particularly in areas that experience multiple levels of deprivation such as the Far North and South Auckland.

The investor would need to identify one or more CDFIs and/or SIFIs that serve communities within its boundaries. For example, the Community Finance partnership in New Zealand which is run by Good Shepherd New Zealand working in partnership with BNZ (providing capital), MSD (funding operational expenses) and community partners such as the Salvation Army. BNZ has committed $60 million in lending to the initiative and the majority of loans are made to individuals that would otherwise be likely to seek loans from to pay-day lenders[15].

Kiwibank provides capital to a number of micro-finance providers including the Ngā Tangata Microfinance Trust which provides no-interest loans and debt relief loans through a network of budget advisers in Auckland and Waikato[16].

Investments in CDFIs are generally at below market-rate. When investments are made for reasons other than financial returns it is important to consider how this affects a foundation's ability to maintain the real value of its assets in perpetuity. The following steps would be taken:

1. Determine the expected shortfall being the difference between the investment portfolio's return targets and the return to be made from the investment.
2. Understand whether the rest of the portfolio can compensate for this investment or allocate the "expected shortfall" to the granting budget.
3. If allocating to the granting budget, compare the benefit of this investment with other potential grant funding opportunities.

15 BNZ website, https://www.bnz.co.nz/about-us/media/2016/expansion-of-community-finance-initiative
16 Kiwibank website, https://www.kiwibank.co.nz/about-us/more-about-us/sustainability-and-corporate-responsibility/

Summary characteristics

Risk	Moderate – specialist intermediaries reduce risk that may be present for underlying investments into social impact organisations or individuals.
Financial return	Below market-rate. CDFIs provide finance to unserved or underserved parts of the market. This is generally done at a below-market rate; therefore CDFIs need to raise capital at a below-market rate.
Strategy	This would align with programmatic strategy.
Impact measurement	A foundation could expect the CDFI or SIFI to understand the impact for the organisations or impact for the individuals as part of their screening process but ongoing impact measurement is not a requirement. The CDFI should be reporting on its performance with metrics such as number of organisations or individuals supported.
Deal creation and assessment	Undertaken by the CDFI or SIFI.
Cost	Minimal cost – a foundation must bear the cost of selecting CDFIs to invest in and administrative costs of that investment.
Decision making	Specialist CDFI or SIFI makes investment decisions.
Investee relationship	No direct relationship with investee organisation or individual.

Pros

- This offers a new financing mechanism that can have a significant impact in target communities.
- It may be relatively easy for investors to engage in this activity if a suitable CDFI, with a track record, can be found i.e. investing with an existing partnership.

Cons

- There are limited options for CDFIs in New Zealand that are engaged in lending to organisations thus limiting opportunities.

3. Responsive impact investment: Respond to 'mixed-motive' opportunities led by external parties

Intent

Respond to investment opportunities brought by third parties that align with programme strategy or priority issues, or test new approaches that may enhance impact at a systems level.

How

Allocate a percentage of corpus assets to be made available from time to time to invest in third party driven opportunities (e.g. managed funds or SIBs) in response to unsolicited opportunities.

The intent of this strategy is to provide the infrastructure for a foundation to respond to investment opportunities that align with programme strategy or priority issues, or test new approaches that may enhance impact at a systems level.

The strategy would take a mixed-motive approach, investing in opportunities presented to a foundation that provide a reasonable expectation of return, if not a market-rate return. The investments are likely to be opportunistic so in order to make the process more efficient and increase the likelihood of being able to support such initiatives, the foundation should work with its fund advisor to understand how a percentage of investment funds could be accessed when required without interfering with investing strategy objectives.

As with Example Strategy two, trustees should consider whether the investment would make returns in accordance with the investment strategy. If not, follow the below steps:

1. Determine the expected shortfall, in this case, being the difference between the expected returns of this investment and the investment instrument from the portfolio that this one is replacing. Take into account both the financial return and risks associated with repayment.
2. Understand whether the rest of the portfolio can compensate for this investment or allocate the "expected loss" to the grant budget.
3. If allocating to the grant budget, compare the benefit of this investment with other potential grant funding opportunities.

Summary characteristics

Risk	Moderate – this depends on the types of investment a foundation has the opportunity to invest in, but properly intermediated products should mitigate risk.
Financial return	Market-rate or below market-rate. The intention would be to make returns that go beyond breaking even in managing this percentage of the corpus.
Strategy	This would align with programmatic strategy.
Impact measurement	Managed by the third party who presents the deal to a foundation.
Deal creation and assessment	Deal creation would be managed by the third party who presents the deal to the foundation. The foundation must undertake its own assessment of the merits of the deal or outsource this assessment.
Cost	Moderate – the main cost is undertaking independent deal assessment. This cost will be allocated to the grant budget.
Decision making	A foundation's trustees or delegated decision maker would decide which investments to make.
Investee relationship	No direct relationship with investee organisation(s).

Pros

- Leveraging the skills and activity of third parties.
- This is a reasonably passive approach and requires a lot less resource than a pro-active approach.

Cons

- Completely reliant on third parties driving activity.
- Less control over which impact areas are focused on than a pro-active approach.

Figure 5: The Barrow Cadbury Trust Total Impact approach [17]

Endowment

Majority of endowment invested in mainstream markets, avoiding companies whose activities conflict with the aims of BCT. BCT is a member of the Charity Responsible Investment Network, facilitated by ShareAction, which engages with investee companies on specific issues in order to get them to adapt their approach.

Social investment carve out from endowment

Charitable activity

Returns from investment portfolio used to provide grants to organisations working to:

- promote criminal justice
- promote an immigration system that is fair to both migrants and established residents; and
- support effective approaches to reducing economic and social injustice and assist in building resilient communities

Social investment carve out

Investments from social investment carve out to date:

Peterborough social impact bond – £100K equity investment to reduce reoffending rates.

Social Justice and Human Rights Centre Ltd – £700K investment (£350K equity and £350K loan) to buy and refurbish property to be used as office space and hub for social justice organisations.

Ethex – £50K investment into Ethex; a new trading platform for social investments.

Bristol Together (BT) – £200K loan to provide work and training opportunities for ex-offenders.

Big Issue Invest Social Enterprise Fund – £250K investment in Social Enterprise Investment Fund.

Essex Looked After Children Social Impact Bond – £200K investment (mixture of equity and loan) to fund payment by result project working with families of young people at risk of being taken into care.

Energise Innovation Ltd – £144K investment in social impact bond to improve school attendance and performance.

T&T Innovation Ltd – £56K investment in social impact bond to improve school attendance and performance.

Golden Lane Housing – £250K investment in 4% 5 year bond.

Midlands Together – £205K investment in a 5 year bond.

Social Venture Fund II – £250K investment in the Germany-based social organisation fund.

17 How foundations are using Total Impact approaches to achieve their charitable missions, UK Government, 2014.

4. Pro-actively generate 'impact-first' opportunities (with or without intermediary)

Intent

Invest in organisations that deliver impact in line with programme strategy and priority issues in order to grow the capital available to impact organisations in Auckland and Northland.

How

Create an impact investment "carve-out" fund. Work with an intermediary to build a pipeline of potential investments or build internal capacity to pro-actively identify and assess opportunities.

Create a "carve-out" or specific impact investment fund and design a strategy for using impact investing to directly deliver impact in line with it programmatic aims and priority issues. The intention for this programme would be to expand the scale and types of capital available to social impact organisations in order to maximise programmatic impact.

Depending on internal capacity and resource, this strategy could be implemented in-house or by outsourcing it to an intermediary.

The fund would operate closely with a foundations granting activities. For each investment, the following steps should be taken:

1. Determine whether the applicant's activities are aligned with a foundation's mission or programmatic goals and whether there is any capacity (present or future) to repay (i.e. trading activities). If there is no capacity to repay, the activities are suitable for grant funding only.
2. Determine the risk to the "carve-out" fund's capital base, taking both the terms of the investment and the risk that it presents into consideration. The amount that this risk represents (risk share) will be allocated to the grants budget.
3. Consider the impact of this investment opportunity against other potential uses of the risk share through the granting budget.

Summary characteristics

Risk	High – the individual investments made would likely carry a high level of risk, which needs to be mitigated using the approach set out above.
Financial return	Below market-rate – ideally the fund would cover its costs, but making a financial return is not the goal. Any anticipated "loss" must be allocated to the grant budget[18].
Strategy	This would align with the funding / programmatic strategy.
Impact measurement	Detailed impact measurement will be required from investee organisations so that a foundation can determine whether its MRI programme is meeting its desired goals.
Deal creation and assessment	Completed by the MRI team or intermediary.
Cost	High – the MRI team will need to undertake a bespoke approach to developing deals, undergoing due diligence and monitoring performance for each investee. The cost of running the programme that is not covered by financial returns must be allocated to the grant budget.
Decision making	The trustees would make investment decisions, but may delegate this power to the MRI team/intermediary.
Investee relationship	The MRI team/intermediary has a close relationship with investee organisations and is able to provide their expertise to support the organisations.

Pros

- Provides a foundation with complete control over the types of organisations and the types of impact that will be supported.
- Engaging in activity that addresses a significant gap in the New Zealand market – by focusing purely on how to best support social impact organisations.

Cons

- Resource intensive approach. There are few intermediaries in the market that have capability in undertaking due diligence with respect to financial and impact capacities of investee organisations.

18 For examples of how to do this, see the Gates Foundation example on page 35.

5. Support impact investment infrastructure

Intent

Support the growth of quality investment opportunities by supporting innovation, investment readiness and infrastructure to create an efficient support system for social impact organisations.

How

Support impact investment development with or without investing directly. This may include activities necessary for organisations to prepare for impact investment from other investors e.g. funding investment due diligence (as with the SIB), providing guarantees to lenders, or funding intermediaries that carry out investment readiness programmes.

This strategy does not involve making any investments, but requires a granting programme that strategically supports impact investing infrastructure. The aim would be to build up the market of intermediaries that are necessary to create efficient transactions that are viable for broader range of investors. Strategic grants could include:

- Capability building grants to social impact organisations
- Grants directly to intermediaries (e.g. capability builders, sector bodies, CDFIs and SIFIs)
- Investment readiness grants to social impact organisations.

For examples and further explanation of these types of strategic grants, see the section on “Building Capability and Supporting Innovation”.

Pros

- Building infrastructure will not only make it easier for a foundation to participate in impact investing in the future but will do the same for other parties – potentially leveraging a lot more activity in the space.
- No need to understand how this approach will align with legal duties and investment strategy.

Cons

- No financial return – uses up a portion of grant spend.
- Not introducing new capital into the sector.

Conclusion

A well-considered impact investing strategy fits well with the aims of a philanthropic funder to maintain trust assets in perpetuity and to support organisations promoting social and community benefit. Impact investing can be incorporated into a foundation's investment strategy and used as an additional high-impact tool that can be used alongside grant funding programmes.

Internationally, the philanthropic sector is impact investing activity is making up almost half of the impact investing market. A number of New Zealand community trusts and family foundations have already been engaging in mission related investment, some since the 1990s.

There are many ways that foundations can begin with impact investing, either through intermediaries (example strategies one and two above) or by developing a mission-related investment programme that invests directly into social impact organisations (example strategies three and four). The New Zealand market is nascent and the opportunities for philanthropic organisations to impact invest here are limited, or hard to identify, because of the current lack of infrastructure. For this reason, foundations might decide to support the increasing number of intermediaries and sector bodies that are developing to fill these gaps (example strategy five). This is a longer-term approach that would aim to increase a foundation's ability to make intermediated investments in the future.

Developing an impact investment strategy requires careful consideration of how it will fit with existing investment and programmatic strategies. Once a strategy has been determined, investors should work closely with its fund managers, legal advisors and impact investing specific external advisors to determine how to implement the strategy while meetings its investment related obligations.

capital such as these will increase their ability to access capital at a level that goes beyond what is traditionally available through grant funding.

In New Zealand, over 50% of social sector income now comes from trading activities. Despite this income generation capacity, the sector is not yet able to address society's challenges sustainably and at a scale that is necessary to overcome them.

These trading activities, however, mean that social sector organisations have capacity to service investment, and these organisations are increasingly seeking to learn more about how they can access this type of funding. This has resulted in a number of parties beginning to build investment infrastructure including managed investment funds, social finance intermediaries and social impact bonds. This new activity is only starting to scratch the surface of the demand. Much more will be required in order to make investment an accessible and efficient option for social sector organisations.