



**THE CENTER FOR
HIGH IMPACT PHILANTHROPY**
The University of Pennsylvania

Program-Related Investments

IS THERE A BIGGER OPPORTUNITY FOR MISSION INVESTING BY PRIVATE FOUNDATIONS?

The number of private foundations in the U.S. and the amount of their endowments has grown considerably over the past decade (see Appendix Chart A). In 2013, 87,000 U.S. foundations collectively held about \$800 billion in endowments. Such foundations annually spend at least 5% of their endowments, typically on grants and support costs to benefit their charitable missions—funding that totaled a minimum of \$40 billion in 2013. However, few foundations actually go further and use social impact investing tools—such as Program Related Investment (PRI) and Mission Related Investment (MRI)—to advance their charitable missions beyond grant making.

PRIs/MRIs have the potential to not only further the mission of a foundation, but also unlock additional financing for social initiatives. Yet, while many

foundations have explored opportunities to leverage PRIs/MRIs to further their missions, the level of such outlays is surprisingly small, comprising less than 2% of private foundation endowments. Why? A number of barriers exist that prevent the broad use of such social investing tools.

These barriers should be understood and addressed to potentially expand the depth, breadth and use of private investing tools since they have the possibility to greater amplify a foundation's core mission as well as provide subsidized debt or equity to social enterprises. If private foundations spent 3% more of their endowments on PRIs and MRIs, an additional \$24 billion in capital could become available to enable improved sustainability of social enterprises and the recycling of philanthropic capital.

ABOUT THE CENTER FOR HIGH IMPACT PHILANTHROPY

The Center for High Impact Philanthropy is the global authority on analyzing opportunities for social impact and practicing high impact philanthropy. Based at the University of Pennsylvania's School of Social Policy & Practice, its multi-disciplinary team provides public information, education, and advisory services to funders around the world seeking greater social impact. For more information, visit www.impact.upenn.edu.

AUTHORS

- **Richard Henriques**, Senior Fellow at the Center for High Impact Philanthropy and Wharton Social Impact Initiative
- **Arjun Nath**, Research Assistant and Wharton MBA candidate
- **Carra Cote-Ackah**, Director, Partnerships and Strategic Initiatives
- **Katherina Rosqueta**, Founding Executive Director and Adjunct Faculty

METHODOLOGY

The goal of this paper is to 1) gain an empirical understanding of the current state of foundation use of mission investing (PRIs and MRIs) and 2) identify the barriers that could explain what we found, i.e. the relatively low percentage of capital deployed via mission-investing vehicles. To accomplish these two goals, the Center synthesized dozens of conversations with individuals active in the philanthropy sector, analyzed available data sources and leveraged field experience. The data sources and organizations from where we sought input are listed in the Bibliography and helped drive the analysis and hypothesis articulated in this paper.

SUMMARY

In this paper, the reader will find definitions, analyses of Mission Investor Exchange data to outline the current state of the sector, and barriers to the use of mission investing with specific examples. It also includes our team's thinking on what, if provided, might remove the obstacles. These findings are organized in the following sections:

1. Differences between PRI and MRI

There is insufficient understanding of the definition of PRI and MRI. Both PRIs and MRIs provide some level of financial returns from the social enterprises they invest in, but PRIs and MRIs are characterized and treated differently by the Internal Revenue Service.

2. Limitations and Operational Challenges of including PRI/MRI into Foundation Strategy

Foundation board members and management often lack sufficient understanding and appreciation of how PRIs and MRIs can enable programmatic success. For example, traditional focus is often on grant making and maximizing financial return on the endowment.

Specificity of program goals can limit the range of investing opportunities. For example, based on the Mission Investors Exchange (MIE) database, of the \$1.3 billion total invested between 2010 and 2015, just 12% of the PRIs and MRIs was directed towards education. Therefore, a foundation focused on education may be limited to a similarly narrow spectrum of opportunities.

Internal foundation processes, resources and expertise may not be appropriate or sufficient to implement a PRI or MRI. For example, most foundation staff have little or no experience or training in the financial due diligence required to execute a PRI or MRI.

3. Need for Improvement in Data and Technical Expertise

In order to execute a PRI or MRI, foundations must navigate a complex system. Currently, that system is characterized by weak financial and social outcomes data, often unclear legal guidance, and advisory services that are relatively new and may not be completely effective in sourcing and executing PRIs and MRIs.

4. Conclusions and Next Steps

1 – THE DIFFERENCES BETWEEN PRI AND MRI

Social impact investing allows foundations to support their charitable missions beyond just grant making. While charitable grants are rarely repaid, investments in social enterprises have the potential to generate a financial return for the foundation, thereby boosting the pool of money available for future grants or investments. Both PRIs and MRIs provide some level of financial returns from the social enterprises they invest in. But PRIs and MRIs are characterized and treated differently by the Internal Revenue Service.

PRI

A PRI can be counted, along with grants and program support costs, towards the 5% minimum payout required for private foundations annually. The returns on the investment, in the year they materialize, are added to the 5% minimum payout requirement for that year, which serves to recycle the philanthropic capital.

What's more, there is no limit on the actual return on a particular investment, as long as charitable purpose is the primary consideration when making such investment. There are no prescribed limits on the size of the investment, the type of investment vehicle or the type of enterprise receiving the investment.

A review of data from the Mission Investors Exchange, a group comprised of 230 foundations and mission investing organizations, shows that the size of PRI commitments varies considerably: from \$20,000 to \$76 million (See Chart B). Investments can and have been made in a wide range of entities including small non-profit organizations, biotech startup businesses and publicly traded corporations.

MRI

An MRI both furthers the philanthropic mission of the foundation AND seeks to generate a competitive rate of return. Similar to a PRI, an MRI can be made in any asset class; however, since it is not designed to meet the IRS requirements to qualify as a PRI, the MRI will not count towards the foundation's annual 5% payout requirement. MRIs have been little used to date, in part due to fear of violating "jeopardizing investment" laws, which require foundation managers and directors to avoid investments "that show a lack of reasonable business care and prudence in providing for the long- and short-term financial needs of the foundation."

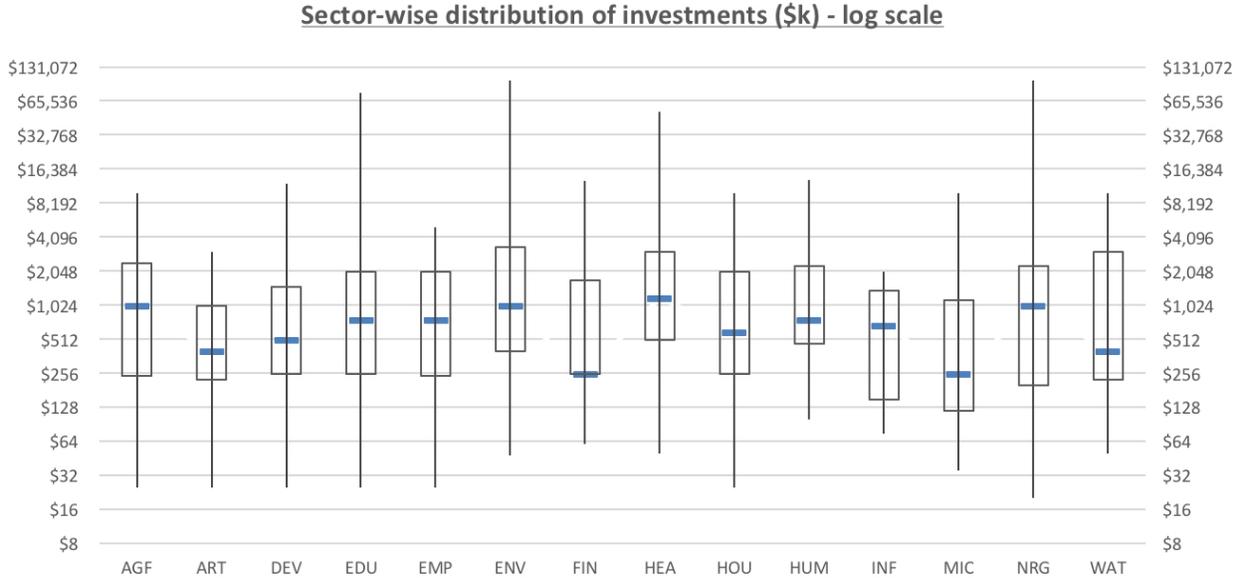
In 2015, the IRS clarified the rules by indicating that it is not a jeopardizing investment just because foundation managers consider social impact consistent with the foundation's mission when making the investment. They "are not required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as foundation managers exercise the requisite ordinary business care and prudence under the facts and circumstances prevailing at the time of the investment in making investment decisions that support, and do not jeopardize, the furtherance of the private foundations charitable purposes."

CHART B

Median PRI/MRI outlay is \$250,000 to \$1.18 million

The investments can be of any size. For example, PRI/MRIs in Education (EDU) can range from a low of \$25,000 up to \$76 million.

(Chart note: the vertical line indicates the minimum and maximum investment; the top and bottom of the rectangular box indicate the 1st-3rd quartile.)



AGF - Agriculture & Food; ART - Arts, culture & humanities; DEV - Community & Economic Development; EDU - Education; EMP - Employment & job-related; ENV - Environmental conservation & protection; FIN - Financial Services (excl. microfinance); HEA - Healthcare; HOU - Housing; HUM - Human & social services; INF - Information / comm technologies; MIC - Microfinance; NRG - Energy; WAT - Water & sanitation

Source: Center for High Impact Philanthropy analysis of Mission Investors Exchange data



2 – LIMITATIONS AND OPERATIONAL CHALLENGES OF INCLUDING PRI/MRI INTO FOUNDATION STRATEGY

There is a wide range of strategic approaches to the use of PRIs and MRIs. Among 29 foundations that have most aggressively implemented mission investment strategies, two thirds have invested less than 5% of their endowments over six years. Within the same six-year period of 2010-2015, the range of investments among those foundations has spanned as low as 1% of an endowment (e.g. Robert Wood Johnson Foundation) to nearly 40% of an endowment (Consumer Health Foundation) (see Chart D). Endowments of this set of foundations vary from \$14 million to \$42 billion, with the higher use of PRIs

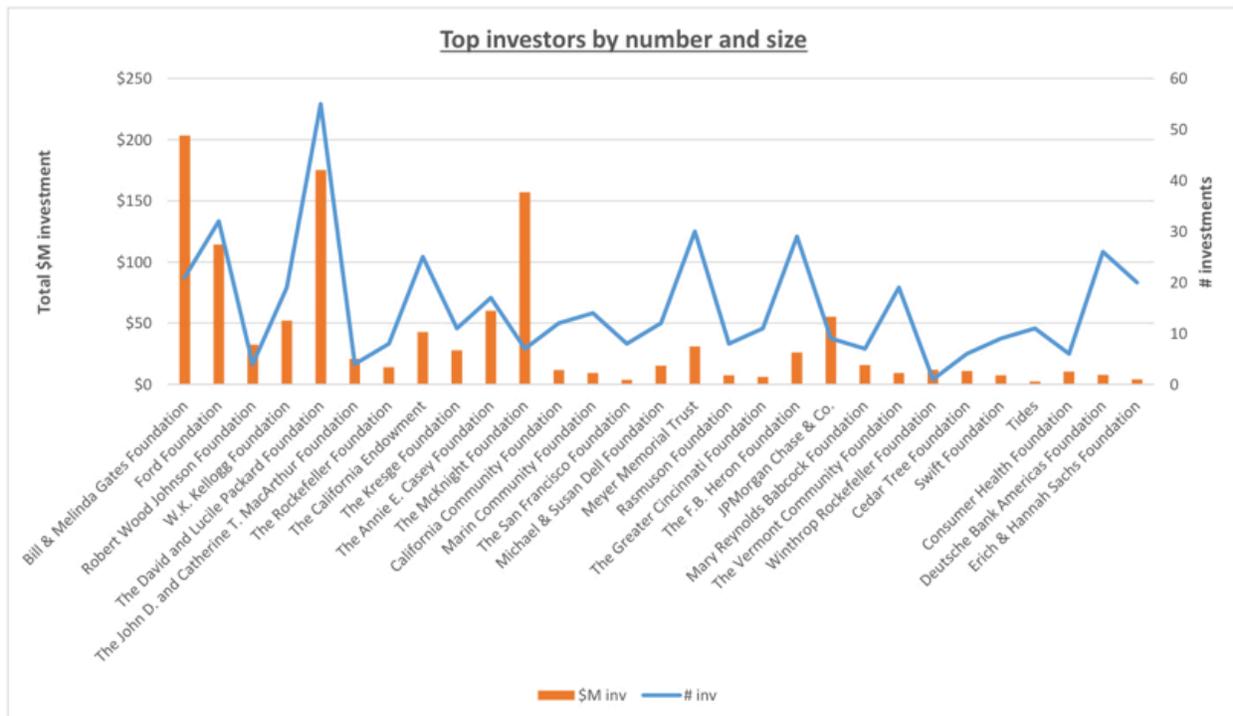
and MRIs found among the smaller foundations. In other words, while some may presume that PRIs and MRIs are a tool for larger foundations, it appears that smaller foundations are more aggressive in their use.

In order to assess whether mission investing is an appropriate tool to achieve programmatic impact, foundation leadership should understand a spectrum of strategic choices. Charts C, D and E show the range of approaches taken by private foundations, the degree of PRI and MRI use, the range of sectors chosen, and the types of asset classes.

CHART C

Top 29 PRI/MRI investors by \$ and number of investments

The Bill & Melinda Gates Foundation reports ~\$200 million in 21 investments during the 2010-2015 time period. By comparison, the Herron Foundation reports \$26 million invested in 29 investments.

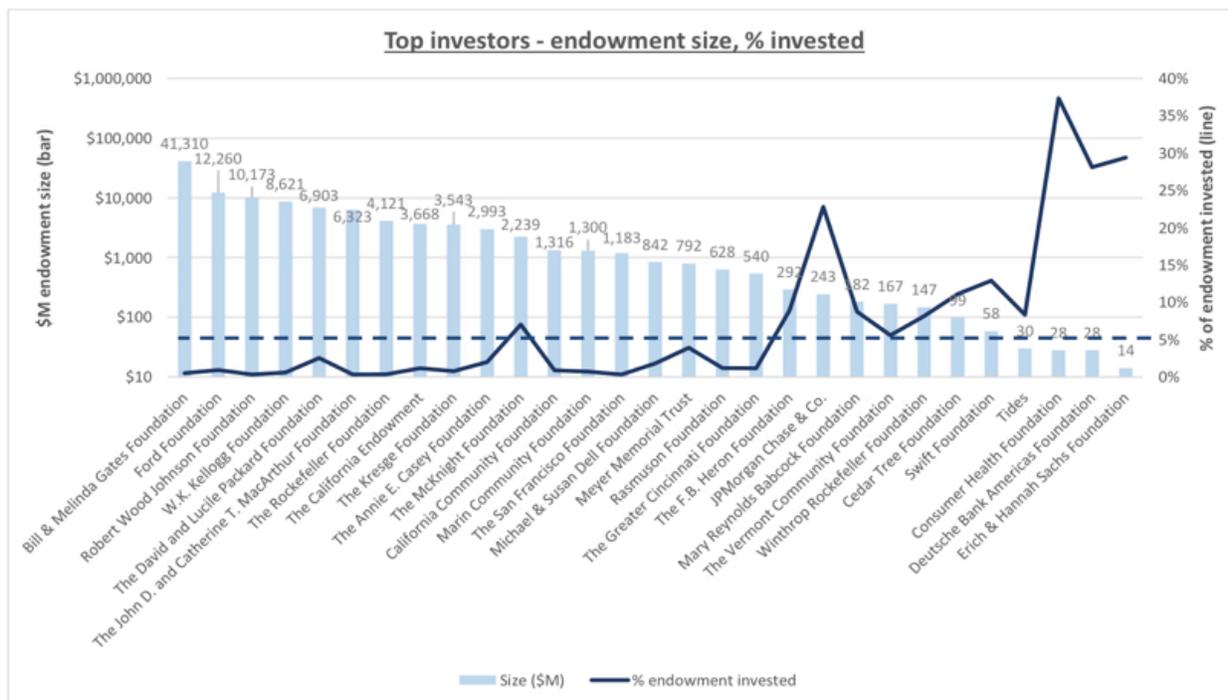


Source: Center for High Impact Philanthropy analysis of Mission Investors Exchange data

CHART D

Of the 29 foundations listed below, 12 have used >5% of their endowments towards PRIs/MRIs.

Smaller foundations are doing relatively more (in proportion) of PRI/MRI investing. Cedar Tree Foundation, for example, with ~\$100 million in endowment, has placed >10% in PRIs/MRIs.



Source: Center for High Impact Philanthropy analysis of Mission Investors Exchange data; Foundation size data from foundationcenter.org – data as of 2013



Why Invest in PRI/MRI?

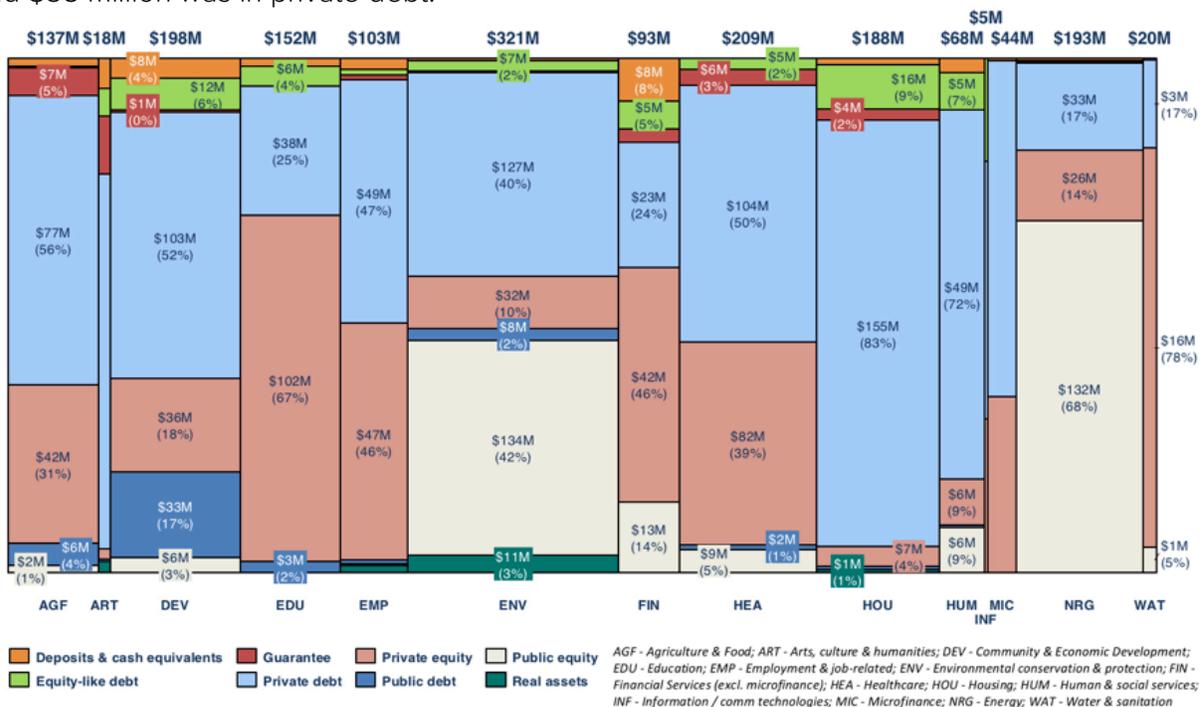
Unlike most grants, an investment can infuse much-needed capital into organizations with incentives to build a sustainable business model, e.g. generate cash to provide a return, build disciplined business practices around planning and resource allocation, etc. There is also the potential to attract additional capital by reducing risk for other more traditional investors through taking a first loss position or providing a guarantee (such as a loan or volume guarantee). For example, private foundations have offered to guarantee the purchase of vaccines and medical devices for use in the developing world as an incentive for private corporations to deliver those vaccines at a dramatically reduced price. Finally, the capital invested in a PRI or MRI will likely be returned in the future for recycling into the mission—creating a multiplier effect on social impact.

A question to consider is whether there are investable opportunities consistent with the foundation’s mission and programmatic goals. Unfortunately, there is a lack of consistent data to help understand the outcome and investment performance experienced by other foundations in social sectors such as environment, education and health. (Chart E provides summary level information on investments across sectors by asset class). Anecdotal information and some data are available to help guide the strategic and tactical options available to foundation leadership through such sources as the [Mission Investors Exchange](#), [Nonprofit Finance Fund](#) and the [Foundation Center](#). A well thought out theory of change developed by foundation leadership is also an extremely useful point of departure to focus this assessment, i.e. how will a mission investing strategy advance the mission.

CHART E

~\$1.3 billion of reported PRIs plus MRIs were made in 14 different sectors utilizing 8 investment vehicles (2010-2015)

For example, of \$152 million in education (EDU) investments, \$102 million was in private to equity and \$38 million was in private debt.



Source: Center for High Impact Philanthropy analysis of Mission Investors Exchange data

Foundation leadership can then determine its strategic goals regarding deployment of capital using the following tool as a guide:

Strategic framework for investing (PRI/MRI)

	“Status quo”	PRIs from grant-making budget	Endowment carve-out	“Full-blown” impact investing
Potential for social impact	<i>Low</i>			<i>High</i>
Perception of added risk		<i>Low</i>		<i>High</i>
Description	<ul style="list-style-type: none"> • Activity limited largely to grants • Endowment invested in non-impact market instruments to generate returns 	<ul style="list-style-type: none"> • Activity expanded to PRIs but within grant-budgets • Endowment invested in non-impact market instruments to generate returns 	<ul style="list-style-type: none"> • Grant-making as usual • In addition, portion of endowment ring-fenced for impact investment (through PRIs / MRIs) 	<ul style="list-style-type: none"> • Grant-making along with PRIs • In addition, large portion of endowment (up to full amount) dedicated to MRI or impact investments
Pros (+)	<ul style="list-style-type: none"> • Easy to maintain • No additional skills needed • Foundation remains in business in perpetuity 	<ul style="list-style-type: none"> • Low-hanging fruit (easiest switch) • Incrementally greater potential impact 	<ul style="list-style-type: none"> • Substantially greater potential for impact (larger pool of funds utilized for impact / mission) • Risk confined to portion of portfolio 	<ul style="list-style-type: none"> • Full utilization of available funds for mission / impact purposes • Sustainable potential for impact with goal of sunseting foundation
Cons (-)	<ul style="list-style-type: none"> • Lowest level of potential impact • Endowment not highly leveraged to achieve social impact 	<ul style="list-style-type: none"> • Endowment not highly leveraged to achieve social impact 	<ul style="list-style-type: none"> • Requires greater care and a broader skillset (to manage portfolio of assets) 	<ul style="list-style-type: none"> • Risk to endowment from lack of diversification, potentially risky investments • Poses potential challenge to life of the foundation



Foundation Operations – Limitations & Challenges

Internal foundation expertise and processes are often optimized for grant making and may be inconsistent with effective identification and execution of PRIs and MRIs. For example:

- Program officers given the task of executing a mission investment may lack sufficient understanding of financial transactions and for-profit business models; investment professionals may focus on financial return at the expense of program goals and become too risk averse in achieving program goals.
- Existing grant making processes may not be suited for managing the flow of PRIs and MRIs such as sourcing, due-diligence and portfolio management. For example, the legal and financial analysis required to complete a debt or equity investment is substantially different than what is required for a grant.

Where mission investing in PRIs and MRIs has become a strategic priority, identifying and allocating appropriate expertise and responsibility is critical to successful execution. Foundations that are inclined to consistently and strategically implement PRIs and/or MRIs should consider:

- Building an internal team (even one individual) with investment expertise who can partner with the program teams to develop and manage the investments,
- Developing a clearly defined end-to-end investment process that embraces and incorporates the necessary financial and legal due diligence required to implement the investment, and/or
- When and how external support can be sourced (e.g. consultants and legal expertise).

While third party providers can be critical to the successful and appropriate use of mission investing, the consulting, business development, legal and fund management skill and experience required to effectively support deal sourcing, due diligence, execution and management of a mission investment portfolio are not fully developed yet or in the preliminary stages of development. To enable appropriate depth and breadth of mission investing, lowering the cost and improving the accessibility of this expertise will be critical. The private sector, academic community, philanthropy (and potentially government agencies) could collaborate to construct the infrastructure necessary to lower the costs and enhance the expertise to lower this critical barrier.

3 – NEED FOR IMPROVEMENT IN DATA AND TECHNICAL EXPERTISE

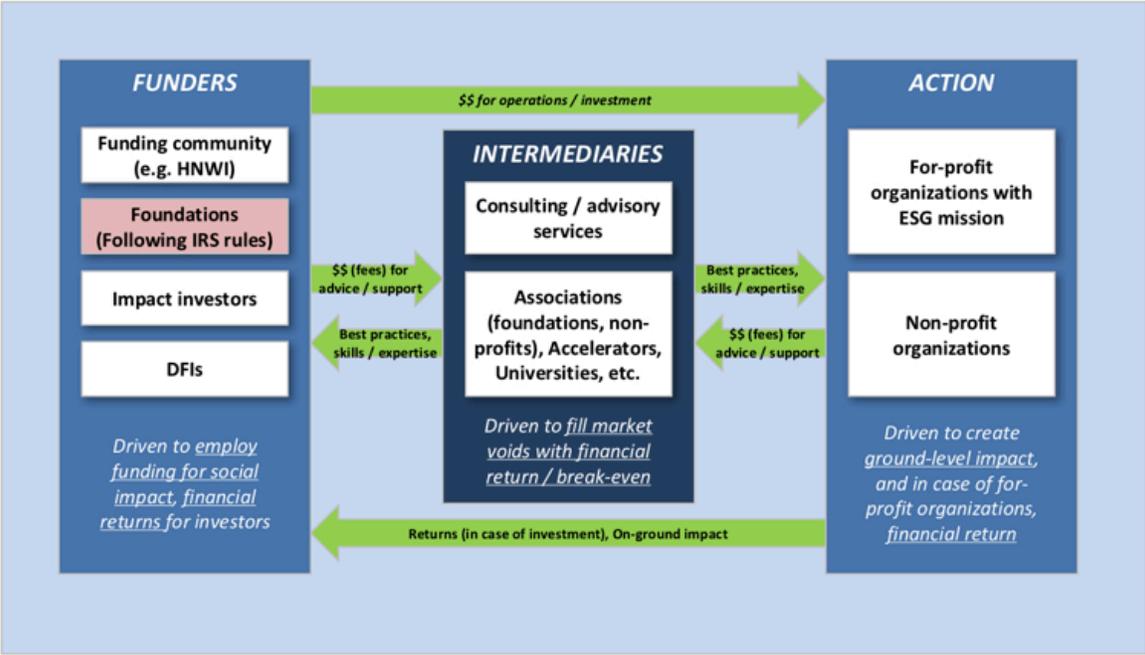
The following chart preliminarily depicts a somewhat complex system that private foundations and social enterprises would need to navigate in order to actively consider using PRIs and MRIs as useful tools to achieve their philanthropic goals.

One weak element in this system is the lack of consistent data to enable a strong feedback loop between the initial investment and the programmatic and financial outcomes from the investment over time. For example, the data in the Mission Investors Exchange database, which is the primary source of the data presented in this paper, is self-reported exclusively by foundations on a voluntary basis and therefore does not represent all mission investing by foundations in the U.S.

Further, the data only represents the investment at the time it is made and does not track performance over time. Investment in the infrastructure to improve the feedback loops should significantly enhance transparency and understanding of mission investing.

Legal requirements and costs can also be significant, which may result from a lack of clarity regarding the specific elements necessary for an individual investment to qualify as a PRI. Further work with foundations and legal experts with experience in implementing PRIs may be necessary to determine if it is useful to develop a set of recommendations for consideration by the IRS and other policy makers.

Players in the system are driven by different motivations and incentives



4 – CONCLUSION AND NEXT STEPS

Our evolving hypothesis is that significant mission investment potential—\$24 billion if foundations redirected 3% of their endowments—could be unlocked if private foundations had access to superior education services, social and financial performance data, and a trusted, high-quality intermediary providing inexpensive due diligence, structuring and underwriting. The next phase of this work is to test the hypothesis that implementing such actions to address the barriers will indeed unlock latent demand for PRIs and MRIs by private foundations. More specifically, the actions to consider include:

- i. Improve access to and reliability of financial and social outcomes data associated with PRIs and MRIs by developing a system that can sustainably capture related financial and social outcomes data, in order to (1) enable foundations to better understand the impact of PRIs and MRIs, (2) allow for benchmarking of investments and (3) provide analytics and insight for the impact investing community.
- ii. Demonstrate a simpler and more efficient approach to financial, legal and social outcomes due diligence by developing a sustainable shared service enterprise (center of expertise or “clinic”) consisting of experts, faculty and students that can support foundations and social enterprises in executing PRIs and MRIs.
- iii. Develop mission investing expertise and capacity to educate current and future leaders in the non-profit and philanthropic sectors.

Successfully building one or all of these capabilities at an academic institution has the potential to create powerful enablers for broader and deeper mission investing, accelerate positive social impact and recycle significant amounts of philanthropic capital.

At the University of Pennsylvania, the Center for High Impact Philanthropy, in collaboration with colleagues from the Wharton Social Impact Initiative, is developing plans to test this hypothesis.

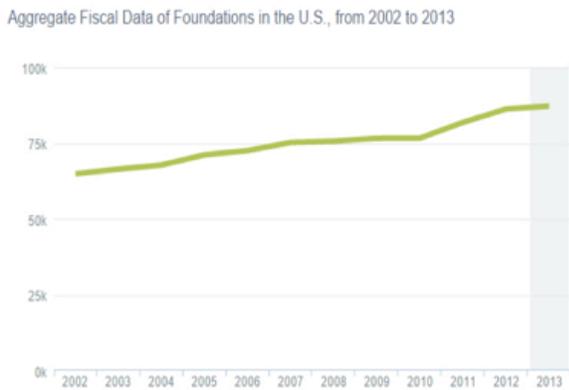
APPENDIX

CHART A

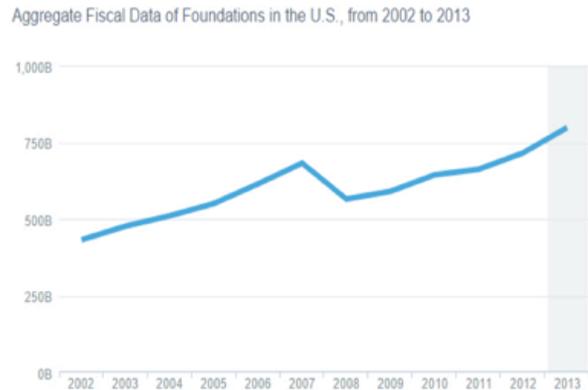
Strong growth in the number of foundations and endowments

The number of private foundations in the U.S. has risen from 64,845 in 2002 to 87,142 in 2013. Endowments have climbed from \$340 billion to \$800 billion over the same time period.

From ~66k foundations in 2003 to ~87k foundations in 2013



>5% annual growth in assets over last 10 years (2003-13)



Source: Center for High Impact Philanthropy analysis of Foundation Center data



BIBLIOGRAPHY

Data Sources

- **Foundation Center** (<http://foundationcenter.org>): For statistics on foundations, location, assets, etc.
- **Mission Investors Exchange** (<https://www.missioninvestors.org>): For database of information on investments (PRI/MRI – further data scrub conducted on searchable database to analyze information by categories (sector/geography/asset class/etc.). The Mission Investors Exchange database (MIDB), which is the primary source of the data presented in this paper, is self-reported exclusively by foundations on a voluntary basis and therefore does not represent all mission investing by foundations in the U.S. Prior to 2014, the MIDB was inclusive only of program-related investments (PRIs).
- **Essentials of Impact Investing: A Guide for Small Staffed Foundations**, produced by Mission Investors Exchange, Arabella Advisors and Exponent Philanthropy, September 2015.
- **Center for Effective Philanthropy** (<http://www.effectivephilanthropy.org>): For anecdotal information on impact investing by foundations. Also see [Investing and Social Impact – Practices of Private Foundations](#).
- **Non-Profit Finance Fund** (<http://www.nonprofitfinancefund.org>): For analytical and anecdotal information on the non-profit sector and foundations.
- **Nonprofit Law Blog**, *Private Foundation: New Rules Recognizing Mission-Related Investments*, by Gene Takagi on September 17, 2015.
- **Team analysis, interviews, discussions**: For detailed statistical analyses, categorization of funding, estimates of added potential, and testing of hypotheses for key obstacles/challenges.

Individuals from these organizations provided valuable input, feedback, and guidance:

Foundations

- Barra Foundation
- Bill & Melinda Gates Foundation
- Open Society Foundations
- Surdna Foundation
- W. K. Kellogg Foundation
- William Penn Foundation

Fund Managers and Advisors

- Bridges Ventures
- Encourage Capital
- Impact Alpha
- Insight at Pacific Community Ventures
- Lions Head Global Partners
- Third Sector Capital

Academic Institutions

- Duke – CASEi3
- Grand Valley State University – Dorothy A. Johnson Center for Philanthropy
- University of Pennsylvania – Wharton Social Impact Initiative

Philanthropy Advisors and Organizations

- Avivar Capital
- Cheshire Law Group
- Council of Michigan Foundations
- Mission Investors Exchange
- Pembroke Philanthropy Advisors
- Social Venture Partners
- Threshold Group

Non Profit Organizations

- Common Market
- PATH
- Economy League of Greater Philadelphia
- A Way to Donate

3815 Walnut Street
Philadelphia, PA 19104

WEBSITE www.impact.upenn.edu
EMAIL impact@sp2.upenn.edu
PHONE (215) 573-7266

BLOG blog.impact.upenn.edu
FACEBOOK facebook.com/CenterforHighImpactPhilanthropy
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