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ELIMINATING MYTHS, ADDRESSING CHALLENGES

There are still many common misconceptions about the nature of Impact Investing. This section will dispel common myths and address some of the challenges that foundations often encounter.

FALSE ⊗

~~1. Foundations are prohibited from making impact investments.~~

TRUE ✓ authored by MILLER THOMSON AVOCATS | LAWYERS

Impact Investing can be done. There are a number of ways a foundation can meet the prudent investor standard, CRA requirements, and the Board's responsibilities for oversight of the assets.

The prudent investor standard applies to a foundation's portfolio as a whole. A foundation can include prudent investments that are aligned with or will advance the foundation's mission. This is true even if impact investments carry greater risk or will lower the overall financial returns in the portfolio, provided that the portfolio as a whole is appropriately balanced and diversified so as to meet the foundation's current and future financial needs. There is considerable scope within the CRA's understanding of market rate investments to make impact investments within a balanced portfolio that accepts lower financial returns in favour of impact aligned with the foundation's mission. Of course, donor restrictions or provisions in the foundation's governing documents should be reviewed to ensure they don't limit scope for Impact Investing.

The Income Tax Act and CRA guidelines also give foundations scope to make impact investments. Impact investments in other registered charities can be made on any terms the foundation sees fit (subject to any conditions on the funds or in the purposes of the charity). Where the investee is not a qualified donee, an investment that is not at market rates must be structured as a Program-Related Investment ("PRI"). A PRI in a non-qualified donee requires the foundation to have some oversight or control in the investee's work. Generally, foundations will want to establish a connection between their impact investments and their overall charitable mission. Foundations are also now eligible to invest directly in limited partnerships, provided they are a true passive investor and stay within certain defined thresholds. This opens up an opportunity for foundations to invest in Funds that are structured to invest for impact.

FALSE ⊗

~~2. Impact investing involves taking lower returns or greater risk.~~

TRUE ✓

Impact investments can generate competitive risk-adjusted returns.

A foundation is likely to have a portfolio with a range of expected financial returns. Of these, only program-related investments can deliberately target a lower return in exchange for a deeper impact in line with a foundation's charitable goals. Thankfully, a growing body of research and market data shows that market-rate-seeking impact investments can generate their target returns and even outperform the market.

A recent study by **Cambridge Associates** found that the overall returns of private equity impact investment funds were comparable to those of conventional funds. These funds can also outperform; smaller impact funds under $100 million returned a net internal rate of return (IRR) of 9.5% compared to 4.5% for similarly sized traditional funds.

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91%

of Impact Investors had financial performance that either met or exceeded their expectations.

A separate study by the **Wharton School of Business** found that market-rate private equity impact investments can be financially competitive with other equity investments. Looking at other asset classes, Cambridge Associates found that risk-adjusted market rates of return are achievable in real asset impact funds, with a distribution of fund returns that mirrors those for conventional funds.

Recent surveys by the Global Impact Investment Network (GIIN) show that Impact Investments met or outperformed investor expectations for risk, return and impact across asset classes:

- 89% of 158 global impact investors surveyed in 2015 said their investments performed in line with, or better than expectations.
- 91% of 209 global impact investors surveyed in 2016 said their investments performed in line with or better than expectations.
- In 2016, 90% of 80 Canadian impact investors surveyed said their investments met or outperformed expectations.

FALSE ⊗

~~3. In the long run, impact investing will take dollars away from charities.~~

TRUE

Impact investments complement grant making.

In many cases, recipients of impact investments are local charities that are ready to take on investment. Impact Investing is a tool for foundations to generate more good by using untapped resources (endowment funds, program-related investments, and local knowledge and networks). They enable foundations to provide much-needed capital while they grow socially and environmentally focused enterprises that align with their charitable missions.

FALSE ⊗

~~4. Only large foundations with significant staff resources can make impact investments.~~

TRUE

Foundations large and small are making impact investments. To succeed, investments must be right-sized to your ambitions.

As with all investing, large foundations may be able to access different opportunities or more easily diversify their impact investments. They may also be able to dedicate resources to overseeing impact investments, even if they're not a top priority.

However, it's not the size of an organization that inspires it to begin Impact Investing; organizations are driven by interest and ambition. Indeed, two global leaders in Impact Investing — the KL Felicitas Foundation and the New Belgium Family Foundation — are mid-sized, with assets of approximately $13 million and $8 million (USD) respectively. This hasn't stopped them from investing 92% of their respective portfolios in impact investments.

Of course, going all-in for Impact Investing isn't right for everyone; there are a growing number of options available for smaller foundations that need a lighter touch or more passive opportunities. For some starting points, consider these **Quick Wins**.

MYTH ⊗

~~5. Due to their uniqueness, impact investments must be considered stand-alone holdings.~~

TRUE ✓ authored by GENUS SVX

Impact investments can integrate into a holistic portfolio.

While mission-based investments have some special characteristics, we believe all investing is best done in a holistic and fully integrated fashion. In the investment world, this is often referred to as a portfolio approach. It's popular because it helps ensure strategic alignment, coordination and diversification.

As with most endeavours, it's important to align your overall strategy and individual tactics with all your goals and objectives. When it comes to investing, this involves making sure your individual holdings and mix of investments are a good match with risk, return and impact expectations.

A portfolio approach facilitates better coordination, where the left hand knows what the right hand is doing. This is useful as it helps eliminate gaps and overlaps across everything you're doing. Overlapping investments can create more concentration risk than necessary, while gaps can lead to unmet goals. A more integrated method of investing can also help you create smarter diversification throughout your portfolio. In practice, this means it's worth considering each investment not only on its own merits but also on how it relates to your other investments. Intelligent diversification can help improve your total risk-adjusted returns by finding the right balance of various securities and asset classes.

Since the range of sustainable investment options has expanded considerably, we need to design and manage sustainable portfolios with more things in mind. In the past, money managers only had to find the best investments and determine the best overall mix of financial asset classes such as cash, stocks and bonds. Today, we also need to design portfolios with a perfect mix of what might be called 'sustainable investment styles'.

For instance, some lighter green 'responsible' strategies consider ESG to try to add return, but do not offer values alignment. Moving to medium green, some 'socially responsible' approaches screen out unacceptable products to maximize returns with values alignment. Darker green 'liquid impact' options try to help improve the world with competitive returns and no added risk, while 'illiquid impact' investments might offer higher returns for higher risk. Perhaps the darkest of all may be high risk, low return, 'impact first' strategies that do good but have financial trade-offs. In many cases the limitations of some types of impact investments, whether regarding liquidity or returns, can be offset by the advantages of other responsible investments to meet your overall objectives.

"If you are a smaller organization with more nimbleness or flexibility, then I think there are great opportunities to jump in. I don't mean jump at the first opportunity to invest. One option is to begin by co-investing with another foundation and really look at it. See how that fits into what you want to achieve overall. This allows you to ask more meaningful questions. It also lets you understand this ecosystem better, and understand that these are the types of companies, and these are the types of organizations."

Danielle Gibbie,
Executive Director, D. Keith MacDonald Foundation

Jacques Bordeleau
Executive Director, Beati Foundation

Nearly 15 years into our impact investment adventure, with more than twenty investments under our belt, we have never lost a penny. I'm not sure that the financial markets have done as well in the last 15 years!"

"The Foundation's mission is to prevent poverty by focusing on educational success of young Quebecers. During the most recent review of our investment policy, we discussed investment trends... and board members agreed on an envelope of 5% of total assets for Mission-Related Investments."

Sylvianne Chaput
VP & CFO, Fondation Lucie et André Chagnon

"As foundations, we need to be aware that we have investing as a tool for impact from the outset. We've renamed our work Solutions Finance, because it's not exclusively about investing or grant making, it's about designing the best solution for the specific need."

Sophie Méchin
Solution Finance Development Manager, J.W. McConnell Family Foundation

"I think the role for foundations may be to help build out the impact investing market in a way that there's some additionality to it, meaning that it adds something net new overall. There is an interesting role for us to push for what's impactful and doesn't quite fit the market test today, but perhaps can and should in the future."

Derek Gent
Executive Director, Vancity Community Foundation

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ADDRESSING PRACTICAL CHALLENGES

Foundations need a practical understanding of the challenges they may encounter while Impact Investing. Below, we address some common challenges and propose solutions.

challenge #1

Managing Impact investment portfolios may require additional time or expertise.

Reflection

The primary shift for foundations moving into Impact Investing involves establishing processes to identify and assess impact investment opportunities in private markets, as selecting from traditional strategies offered by public securities managers will not satisfy the bare minimums for mission-alignment.

Foundations can choose to either outsource or build internal capacity to manage their impact investments over the long term. Ultimately, foundations need to establish a vision for Impact Investing that fits within their capacity to manage investments. Those with less capacity should opt for more passive investments. A growing body of fund managers are creating simple points of entry for investment for this very reason.

To build in-house capacity, many foundation leadership teams rely on external consultants — including the support service offered with this guide. Some foundations with multiple staff functions have integrated team members from their grant making and finance teams to build the right breadth of experience. This enables otherwise isolated units to exchange knowledge and enhances a foundation's capacity to identify, assess and monitor impactful enterprises.

Examples

Many foundations have built partnerships to minimize the effort of Impact Investing. The **Victoria Foundation** and the **London Community Foundation** have partnerships with their local credit unions to carry out due diligence and administer loans for local community partners seeking credit. Similarly, the **Hamilton Community Foundation** works with the **Community Forward Fund** to administer its local loan program. These partnerships strike a balance between active participation and operational efficiency by having the foundation serve as the entry point for new inquiries. This enables the foundation to assess community needs and strategic fit before passing the inquiry to external support.

"Impact Investing is a very individual journey, but ultimately you have to try it. Find a way for people on your board and your committees to experience it so that it becomes real for them. For example, when someone sees affordable housing being built in a community that needs it desperately, and what that outcome means to the people in the community, it becomes real. Site visits provide answers to most questions. Once they see it, they get it."

Annette Aquin, Executive Vice-President, Finance & Operations,
Hamilton Community Foundation

challenge #2

It may be difficult to find impact investments that fit inside a narrowly defined geographic area or thematic focus.

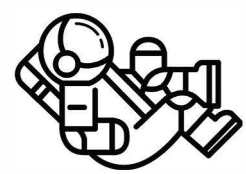
Reflection

Depending on the scope of your mission, the current state of the market in Canada may or may not allow your investments to be as precisely targeted as your grant making. Recognizing these limitations, foundations continue to look for impactful ways to activate their capital when that opportunity is not available.

Can you take a broader perspective on advancing your foundation's mission? By taking a step back to consider how your impact investments can ultimately support and enable your mission, you can significantly expand the number of relevant opportunities. Considering how irrelevant many traditional investments are for your mission, finding the perfect mission alignment can be the enemy of good alignment. For example, a foundation that focuses on early childhood development may choose to invest in affordable housing for mothers and families as a means of alleviating child poverty. It may also choose to invest in a business supporting affordable housing or employment training in a different geography in order to capture the lessons for its own region, and perhaps support the expansion to their locals in future years.

Example

Hamilton Community Foundation is focused on building a vibrant, inclusive Hamilton. The Foundation has created a loan program to invest locally in initiatives that are aligned with its priorities. And it invests nationally in areas that support a world where communities can thrive. These commitments include social ventures, clean technology and affordable housing. More distant investments have helped build the market, enabling the foundation to attract new partners to its home community.



Stepping into the challenges to advance your mission

Despite the challenges, foundations are successfully using Impact Investing as a powerful tool to advance their missions across sectors and regions.

There is no one way to do Impact Investing; each foundation has different capacities, desired impact and financial objectives. As a first step to resolving the challenges you may encounter, recognize that Impact Investing is a complementary tool to grant making that requires a complementary mindset.