Quick Case Guide			
Public Foundation	Publicly Fundraising	Mostly Direct	Finance First
Private Foundation	Non-Fundraising	Mostly In-Direct	Blended
			Impact First

Looking at the full spectrum of solutions finance

In conversation with the McConnell Foundation, April 2017

Established in 1937, the McConnell Foundation is a private family foundation that seeks to engage Canadians in building a more innovative, inclusive, sustainable and resilient society. Since 2007, the foundation has played a critical role in supporting the development of Canada's social finance marketplace. It now uses an integrated approach to deploying financial capital to catalyze systems transformation — called Solutions Finance. We spoke with Sophie Méchin, the foundation's Solutions Finance Development Manager, about this history and where they're going next.

"The future and scale of Solutions Finance will be the collaboration between foundations and other types of investors."

What motivated the McConnell Foundation to first begin to engage in impact investing?

It was a combination of different trends. Fifteen years ago, the foundation began to focus on social innovation. In doing so, we increasingly became a learning organization, and started piloting things in line with the different phases of innovation. This created openness to think out of the box regarding how we could best use our financial resources beyond conventional granting. In 2010, the Canadian Social Finance Task Force recommended that foundations play a role in building the marketplace, and called for Canada's public and private foundations to invest at least 10% of their capital in mission-related investments by 2020. The final trigger was from an existing foundation grantee, Quest University. The foundation had already provided grants to Quest for curriculum development. The university then approached us with a $10M request for a loan rather than a grant. The university had the underlying business model to repay our contribution.

The foundation was repaid early with interest on that first impact investment. It was a success. From there, we were open to move beyond granting. It was also a matter of scaling opportunities, because within our granting budget we wouldn't have been able to make a $10M grant to support any organization.

The Board then set the direction for staff to explore what being an impact investor would mean for the foundation. They gave us a mandate, and the buy-in was there. We were also influenced by what was happening in the wider world, because impact investing was gaining traction elsewhere.

KEY STEPS

- *Consider whether there are gaps in access to financing in the ecosystem you work in*
- *Look to support the development of intermediaries and other organizations that can enable greater systems transformation*
- *Look for opportunities where investing can be thought of as a tool in your programs*

Were there any particularly critical moments or breakthroughs?

It took a few years before the foundation decided to hire dedicated staff to develop the internal skills and capacity to make impact investments. We initially hadn't been set up to do this kind of work. Very early on, there was demand. Another grantee, Evergreen, was interested in an investment related to the Brick Works — a former industrial site in the Don Valley, Toronto. We were also approached by the team that set up Renewal Funds. Essentially, people in the market were setting up funds that started to meet the criteria of the investment committee. Seeing diversified opportunities was a breakthrough for us.

This coincided with a more enabling environment. In 2012, the Canada Revenue Agency released its guidance around Program-Related Investments (PRI). For charities, this greatly reduced the risk of impact investing, and definitely played a role in our decision to go further.

Another key factor was the influence of Social Innovation Generation (SiG), an independent initiative of the foundation that helped create the Social Finance Task Force mentioned earlier. We weren't alone. That sector engagement was contextually important.

How has the strategy evolved and what does Solutions Finance look like now?

From the beginning, we were very intentional about helping build the market. The three core objectives since 2011 have been to increase impact, build the marketplace, and bring capital to the charitable sector. This goes beyond just the actual impact investing portfolio. For market building especially, we included granting as well as convening.

During the first phase, from 2011 to 2016, our mandate was to invest across asset classes. We went beyond 5% of the endowment. Under our current guidelines, the MRI portfolio must meet the requirements of the endowment's overarching policy. The PRIs have to be aligned with the specific domains that we work in. Before that we were doing one-off transactions that were aligned with our mission and with our program areas. Now the investments are more cross-cutting and strategically aligned.

The first question we always ask ourselves when considering an opportunity is around the strategic fit with the mission of the foundation. We then look at the value proposition of the investee and its theory of change. In parallel, we look at the organization's capacity to deliver on what it proposes to do. We then look to develop and negotiate the actual transaction with the investee. Everything we produce is based on those factors, and we've developed a public due diligence guide as a resource to others. The questions we ask have become quite consistent over time. We also actively ask ourselves how we as an investor create impact. We've been measuring the impact of each transaction in three complementary and non-competing ways: the impact we have on the ground, the impact on the investee, and the financial innovation.

Are there examples that illustrate this work?

One example is New Market Funds Society in BC. It is a charitable organization with a mandate to increase the use of impact investing by charitable organizations. They created the NMF Rental Housing Fund. The foundation started as a Limited Partner in that fund via a first PRI. We then made another PRI to invest in the charity as well. New Market Funds positioned themselves as the first pan-Canadian intermediary that would be dedicated to developing impact investing products. It's an example of the role foundations can play to support market building by directly supporting and investing in intermediaries. We try to be quite transparent in our portfolio, and all of our impact investments are publicly available on our website.

How have you had to build capacity?

Focusing on the basics is key. For example, investing means that getting the money back is as important as getting it out. That's new if you're a granting organization. We have monitoring and evaluation functions in our team, but following an investment requires an additional layer of regular monitoring that we didn't have in-house. We had to be able to adequately follow a growing number of transactions. Over the course of a year we were able to build our expertise and systems, and be confident that we could analyze, realize, and monitor transactions cautiously.

What are some of the key barriers and entry points you'd encourage others to consider?

One of the barriers is that this work can be costly. We've also seen that the market is not yet efficient. You can't really set asset allocations and impact objectives, and then shop around for managers to select those investments that best fit your needs, as you would do in conventional asset management.

The benefit of using investment tools is that the scale is different. You can start to address capital-intensive issues that you can't really tackle when you're limited to grant making. You are working with — and for — the community sector, but in impact investing you can also start to engage other sectors. Because many problems we are trying to solve are impacted by broader economic issues, you can start to think about how the private sector has a role to play.

For foundations starting out I see two paths. You could go to existing intermediaries and proven transactions and participate in proven investment opportunities. A different route that is more resource intensive is to start to make direct investments with your grantees. The challenge is that small transactions take at least as many resources as big transactions. That's a big part of why we've chosen to invest through intermediaries rather than directly into organizations.

What is your vision for foundations in impact investing?

Impact investing is a means to an end. Ideally our program directors, as experts in their fields, can now work with a much bigger toolbox: they know they can grant, invest, convene, advocate to government, and engage the private sector. We need to know that we have investing as a tool from the beginning. 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. Foundations have the flexibility to do these different things, and we are exploring the opportunities this creates. It's a way to have more and better impact, and it's something other foundations have also done.

Foundations are the only asset owner in the business of making money *and* spending it on social issues. We are the only ones with the capacity to make flexible and even concessionary investments through PRIs. We can take first-loss positions either to help pilot new initiatives, or to bring other investors on board. Foundations can really influence the market, and we need to get comfortable working with other players in the financial industry. We can change and evolve, but we should think about the unique roles we can play to influence the broader market. The future and scale of Solutions Finance will be the collaboration between foundations and other forms of investors, the public sector and other players from the philanthropic sector.