Local Investing for Impact

Activating Donor Dollars for Local Impact Investments

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Community Foundations, Donors and Local Impact Investing Programs

Community foundations receive generous gifts from donors with the shared understanding that the foundation will create an impactful and lasting community resource. But community foundations wishing to buoy local prosperity may need to consider how gifts derived from local sources including local businesses and homes, even if endowed in perpetuity, may in some cases be a net-loss to the community. Local impact investing offers community foundations the opportunity to build endowments and invest in local economies and communities – taking a portion of the money invested in national and global markets and redeploying that capital to support local entrepreneurship and homeownership, for example.

As with any growing practice, early foundation adopters of local impact investing have selected different paths, but one commonality that is unique to public charities is the recognition of local investing as both a tool for community solutions and a service for donors. Local impact investing multiplies the assets leveraged for community benefit, and it also can be a differentiating donor service that advantages a community foundation and its deep relationships over non-local financial services companies.

Community foundations that actively engage their donors know these relationship building efforts lead to increased community benefit. Inviting donors through multiple entry points (e.g., aligned grantmaking <u>and</u> local investing) enables each donor experience to be meaningful while enhancing the foundation's interests and impact.

Donor Funds and Funding Local Investments

Before a community foundation can think about communicating with donors about their program, they must first design the local impact investing structure - the way that money will flow in and out of the program. LOCUS recently hosted a conversation with leading community foundation impact investors to discuss how donors fit into their local impact investing program. We observed three primary models that community foundations use to activate assets for local impact investing –

through endowed asset allocation, donor recommendation, and gifts/grants solicitation. Each model offers unique benefits and challenges. Regardless of the capitalization source, there are several universal considerations that community foundations should be aware of.

- First, as is the case with all foundation assets, decision-making and governance of these local impact investing assets remains the same – with the board and its appropriate committees.
- Second, board members may not vote on investments that may provide personal benefit.
- Third, return on investment accrues to the community foundation and its component funds. Individual donors may not receive returns directly. Rather, investment returns will be allocated to the foundation and perhaps, a donor advised fund.

Additional Considerations for DAFs

For community foundations whose local impact investing program design invites donor participation through their advised fund, additional strategic decisions must be considered.

1. **Target Return on Investment:** A key differentiator of local impact investing is the expectation of financial return in additional to impact and social return on investment. Foundations must determine how and when participating donor advised funds will receive a financial return, in addition to return of principal.

2. **Return of Principal:** The foundation must determine if the investment principal of participating donor advised funds will be returned to the DAF or recycled into additional investments.

3. **Term of Donor Investment:** The foundation must determine, based on the program goals, the reasonable time frame donor dollars may be "locked up" or unavailable for grantmaking.

4. **Spending policy:** The foundation must determine if the spending policy applies to assets deployed as local impact investments. And if they do, how the foundation will draw resources to cover the illiquid investments.

5. **Fund and activity fees:** The foundation must understand how to cover expenses of the local impact investing program – both transaction-related expenses and program expenses such as staff time and legal or other professional assistance.

By sorting these matters on the front-end, the foundation can clearly communicate how money will flow in and out of the local investing program and highlight opportunities for donors to engage. Through careful planning and preparation, community foundations can strengthen the potential for a sustainable local impact investing program and enhanced donor engagement.

Structures for Engaging Donors in Local Impact Investing

Generally, community foundations take one or a combination of the following three approaches to engaging donors in local impact investing. Each of these methods comes with its own strengths and weaknesses, and community foundations select from these approaches for a variety of institutionally specific reasons. For example, one community foundation may first choose to allocate a portion of all its investable assets because the board is energized by this new approach to having impact while donors may be less knowledgeable about the practice. This foundation may choose to first demonstrate the value of local impact investing broadly before choosing to develop more active donor engagement strategies. The point being, there is no single "correct" starting point for a community foundation to involve its donors. Over time, community foundations often develop compounding local impact investing strategies that flexibly engage donors in ways that bring more impact capital to bear.

Capitalization Option: *Allocation of Invested Assets - including Advised Funds - by the Foundation*

The board may allocate a portion of all invested assets – including all donor advised funds – to local impact investing in a way that sustains grantmaking, preserves endowments, and satisfies the foundation's mission.

- **Potential Upside:** Typically unlocks the most assets for local impact investing. If the allocation is a percentage of invested assets, the fund grows organically over time through rebalancing. The foundation can engage all fund donors automatically – without significant donor education or solicitation – leveraging a portion of restricted assets for foundation-identified, mission-aligned community impact. The approach shares local impact investing risk between the foundation's most precious unrestricted assets and donor funds.

- **Potential Downside:** Because it is an endowment asset allocation strategy, this method may require significant board and staff education – especially board investment and grant committees and finance and accounting staff. The foundation's investment manager may advise against this approach due to perception of risk or loss of assets under management.

Capitalization Option: *Allocation of Advised Fund Assets by Donor Recommendation*

The foundation invites donors to allocate a donor advised fund's investable assets to local impact investing pool, fund, or transaction.

- **Potential Upside:** Donors can recycle charitable dollars (to the community foundation or donor advised fund depending on structure). The foundation may solicit new and existing donors for partnership.

- **Potential Downside:** Donor funds are "locked up" for specified term, unavailable for grantmaking. The foundation may need to train staff and revamp tools to manage the back-office financials – e.g., tracking and allocating to donor funds appropriately. This requires ongoing education and communication with donors about expectations of return on investment to include impact as well as financial return.

Capitalization Option: *Solicitation of Existing/New Donor Gifts/Grants*

The foundation invites donors to make irrevocable gifts or to recommend grants from their donor advised fund to the local investing fund.

- **Potential Upside:** This provides the foundation with the most flexible, most risk-tolerant discretionary funds for local investing. Donor communication can be simple because it is very similar to grantmaking. Losses are isolated to one fund. With simple impact reporting and accounting, the foundation can easily demonstrate the value to donors.

- **Potential Downside:** This typically unlocks the fewest number of assets for local impact investing. Because it is essentially grantmaking, it may not appeal to donors that are hoping for a new tool and expecting to be engaged through the lifetime of the investment.

More Resources

Although some community foundations have made investments for impact for decades, the practice of impact investing by community foundations is still in its infancy. LOCUS is committed to developing field-building activities and resources in partnership with community philanthropy. Visit locusimpactinvesting.org to learn more.