

Mapping the Journey to Impact Investing

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Mapping the Journey to Impact Investing

Many foundations, particularly family foundations, have an interest in exploring mission- and program-related investing, but impact investing is a major undertaking and the learning curve can be steep. Questions arise about how to initiate the process and the kind of capacity needed for implementation, and Surdna was no different when our board and staff began to consider mission-related investments (MRI).

We started the process in 2014 as our board committed to an extensive collaborative learning, exploration, and decision-making process to consider instituting mission-related investing or impact investing policies.

At the end of the nine months, the Surdna Foundation board decided to create a \$100 million – approximately 10 percent – allocation within our endowment for a combination of MRIs and program-related investments (PRI) and to apply a robust variety of other impact investing strategies across our endowment.

For the Surdna Foundation, our learning and decision-making process was well worth the journey. We will now strive to increase the impact of our investments in line with our mission of fostering sustainable communities and guided by principles of social justice. In addition, we are bridging the separation that often exists between endowment investing and grantmaking.

Examining your investment policy involves more than straightforward, technical solutions. Aligning your policy with your mission will raise complex issues that most foundations do not tackle. But in our case, our examination led to productive dialogue and important institutional evolution.

This report focuses on how to organize a generative process to learn about and discuss impact investing, using our own experience as a guide. Existing resources in the field can provide the technical blueprints for making impact investments, so we do not seek to replace those resources. By openly sharing our experience, the Surdna Foundation instead hopes this report will serve as a case study for others in the philanthropic community who choose to explore impact investing tailored to their mission and goals, and that it will contribute to collective learning in the fields of mission-related investing and family philanthropy.

There is no single right way to approach impact investing. But whatever course you follow, our hope is that the tools and tips we provide will help make the trip a rewarding and worthwhile one.

Respectfully,

Peter Benedict, II
Surdna Foundation Board Chair

Jocelyn Downie
Surdna Foundation Board Chair (2013-2016)

THE 50,000-FOOT VIEW OF SURDNA'S IMPACT INVESTING JOURNEY

Many foundations, particularly family foundations, have an interest in exploring mission-related investments (MRI) and program-related investing (PRI), but impact investing is a major undertaking and the learning curve can be steep. Questions arise about how to undertake impact investing and the kind of capacity needed for implementation, and Surdna was no different when staff and board began to consider MRI.

The Surdna Foundation is a national family foundation with strong local and regional investments tied to its mission of creating just and sustainable communities by advancing long-term social change. Aligning its investment portfolio more closely with its mission through impact investing was a natural evolution of its guiding principles. Surdna started an exploratory process in 2014 as the board committed to an extensive

collaborative learning, exploration, and decision-making process to consider instituting mission-related investing or impact investing policies.

At the end of the nine months, the Surdna Foundation board decided to create a \$100 million – approximately 10 percent – allocation within its endowment for a combination of MRIs and PRIs and to apply a robust variety of other impact investing strategies.

The process of deciding on an impact investing strategy required a variety of activities, including:

- Looking at Surdna's existing portfolio through the lens of environmental, social and governance best practices;
- Getting a feel for what a hypothetical portfolio of investments and approaches tied to the mission would look like;
- Learning about the available investment tools; and
- Spending time with peers who have adopted impact investing strategies.

The project was facilitated by a consultant team, The Giving Practice and Veris Wealth Partners, under the leadership of a working group of Surdna Foundation board and staff members. Cambridge Associates, which Surdna contracts for external chief investment officer services (CIO), played a collaborator role, working closely with the Working Group and consultant team to provide important, comprehensive endowment data and other information throughout the nine-month exploration process.

This report is a detailed account of the Working Group's process. Throughout this document, there are anonymous quotes taken from interviews

About the Foundation

The Surdna Foundation, guided by principles of social justice, practices strategic philanthropy to foster sustainable communities across the United States. Its programs address healthy environments, strong local economies, and thriving cultures to create communities whose members lead the way in advancing solutions that increase equitable access to opportunity. John E. Andrus created Surdna in 1917 and five successive generations have guided the Foundation's evolution.



with Surdna board and staff members about the learning process. We begin with the essentials of what they learned.

Start with a framework

A clear framework for decision-making on whether to pursue impact investing allowed the board to maintain a focus on project goals. The consultants' primary task was to build this framework and a toolkit – a list of every impact investing approach the Foundation might employ with Surdna's Working Group. These guides helped all the players use the same language, which is especially important for boards that by nature drop in and out of complex topics over time. The toolkit, in particular, helped Surdna see that an impact investing approach is about a broad range of activities – not strictly about investments.

“We heard case studies of effective shareholder engagement with companies that were very impactful. It [those practices] could become a major part of our approach.”

Listen to voices of experience

Gaining insights from those with impact investing experience proved invaluable, especially for Working Group members who were less familiar with or skeptical about the approach. This included attending impact investing conferences and visiting a foundation that's similar in size and had made the decision to pursue impact investing.

“We saw that we were not out on a ledge. We talked to them [other foundations] about shared concerns and how they managed them [their concerns].”

Analyze your current portfolio

A portfolio analysis was done for the Working Group and then repeated with the staff and full board. This was an important opportunity for the board to apply mission values to its investing practice. What's more, the board is now interested in learning more about the social impacts of endowment investments on an ongoing basis.

Create a hypothetical model

Staff and board members had an opportunity to identify potential themes for mission investing and then look at real-world investments or shareholder engagements that could be made within those themes.

“I saw that we could advocate as shareholders in existing investments related to our grant programs. I wasn't thinking about that.”

AN IMPACT INVESTING ROAD ATLAS

PREPARE FOR THE JOURNEY

Looking back before moving forward

In 2014, the Surdna Foundation began investigating impact investing and mission-related investments by looking at the ways its endowment policies and practices either aligned or conflicted with its mission. It wasn't the first time the Foundation had discussed this, but there was some initial resistance based on past explorations into MRI in the early 2000s. The field was still in its infancy then, and the Foundation didn't find a compelling framework for pursuing it.

In 2008, the board and staff engaged in a major mission redefinition that included a deeper focus on Surdna's social justice goals. That not only led to greater clarity on the Foundation's aims, but also piqued interest in what else could be done outside the grants program to advance Surdna's social justice mission – or at least not inhibit it.

“Having conversations about knowing what you own is so important.”

Prior to exploring all of its endowment practices, the Foundation had taken a significant and public step when it created a program-related investment (PRI) portfolio in 2013.¹ As Surdna looked into creating a PRI fund, its programs were also developing new strategies. The timing was beneficial: As the staff were formulating new program strategies, they considered areas

of potential PRI opportunities. What they found demonstrated the strength of the market in many of Surdna's areas of work. When each fund was created, program staff were ready with a pipeline of investment ideas. This was an important learning experience because both board and staff members gained skills and comfort with an initial set of impact investing concepts.

“Experience with PRIs influenced our thinking about MRIs.”

When Surdna launched an investigation into endowment policies and practices, looking back on prior concerns and addressing them directly helped staff and the board prepare to move forward. The Foundation therefore decided to create a chronology of past events that shaped the decision-making process as a resource.

Match the process to your culture

Surdna values an open, analytical, collaborative culture, and the road to impact investing was no different. There were diverse opinions and perspectives among the board and staff about impact investing in the beginning. But curiosity was the common thread that held the group together.

The nine-month exploration period encompassed a careful consideration process. Keys to success included:

- Making sure everyone stayed updated and concerns were welcomed, heard, and addressed;
- Creating a working group that included

1. Surdna's program-related investment fund constituted 2 percent of its endowment, or about \$18 million. Its creation did not reduce grantmaking allocations; that is, annual spending, including PRI, began to exceed the Foundation's 5 percent minimum payout.

both board and staff;

- Conducting sessions to share what was being learned with all program staff;
- Creating an impact investing toolkit, including selected readings; and
- Providing the full board with regular written updates as well as mini-workshops during their meetings.

“Really important that we focused on learning first and not pushing investments. Calmed the waters.”

In retrospect, Surdna recognizes that it might have done more to encourage information exchanges throughout the organization, such as informal briefings or creating a buddy system for transmitting information. As one board member noted, “Better to overshare in these situations.”

Seek out diverse viewpoints

To structure the impact investing exploration

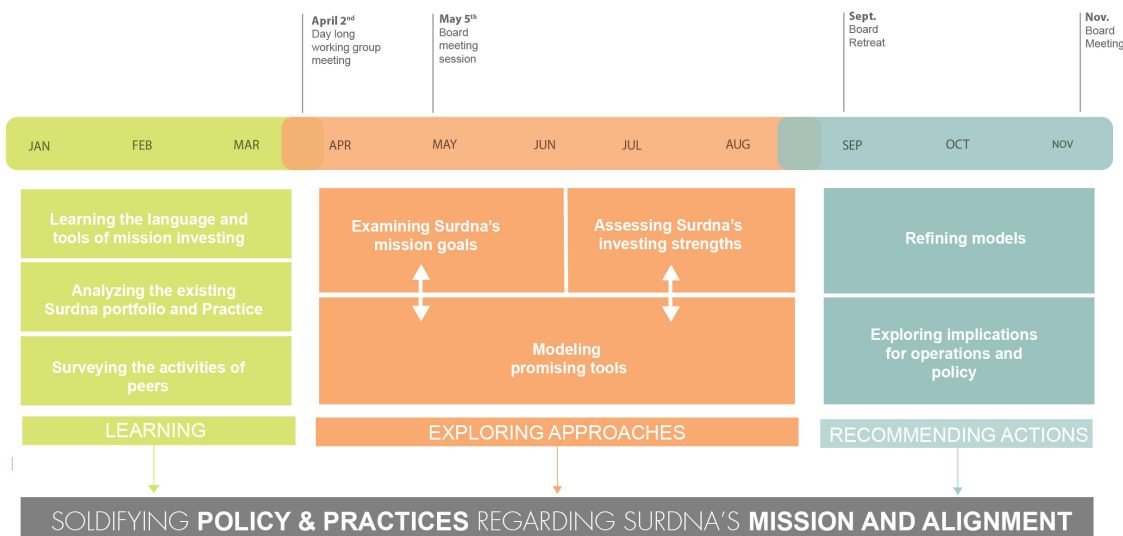
process, Surdna chose a method that has served the Foundation well in other big projects by creating the Working Group for Investment Policies and Practice. The board issued a mandate charging the Working Group to come up with a plan to explore impact investing.

The Working Group included board and staff members on the investment committee as well

“As an experienced social impact investor, part of my role was to offer comfort that we were not out on a ledge to some while managing impatience by others who felt that we could do a lot more.”

as those not well-versed in investment language. The Working Group intentionally included people with varying degrees of passion for and against impact investing. Despite competition for attention against other projects, this diversity of passion and expertise was essential to maintaining momentum

Surdna’s Mission Investing Exploration



and securing organizational buy-in for a full exploration over the nine months.

Having staff in the Working Group who were tasked with keeping the work on the front burner proved invaluable. Staff members included Surdna’s vice president of finance and administration, who is the liaison to the external CIO, and the vice president of programs and strategy, whose focus is mission and program impact.

A board member with expertise in impact investing, who was also on Surdna’s investment committee, served as chair of the Working Group. She saw her role as an “agnostic leader” who could use her expertise to explain data, facts, and opinions to both the enthusiasts and skeptics. Participants valued her guidance as they explored new territory. Surdna’s board chair also joined the meetings. She made sure the Working Group was on track without getting too far ahead of the board. In addition, the board chair incorporated the Foundation’s social justice mission into the impact investing discussion by championing strategies that would advance equity and inclusion.

“To start, I wanted to learn: Do we own anything that would keep us up at night if we knew about it?”

Entrusting the impact investing exploration to a working group made up of stakeholders with

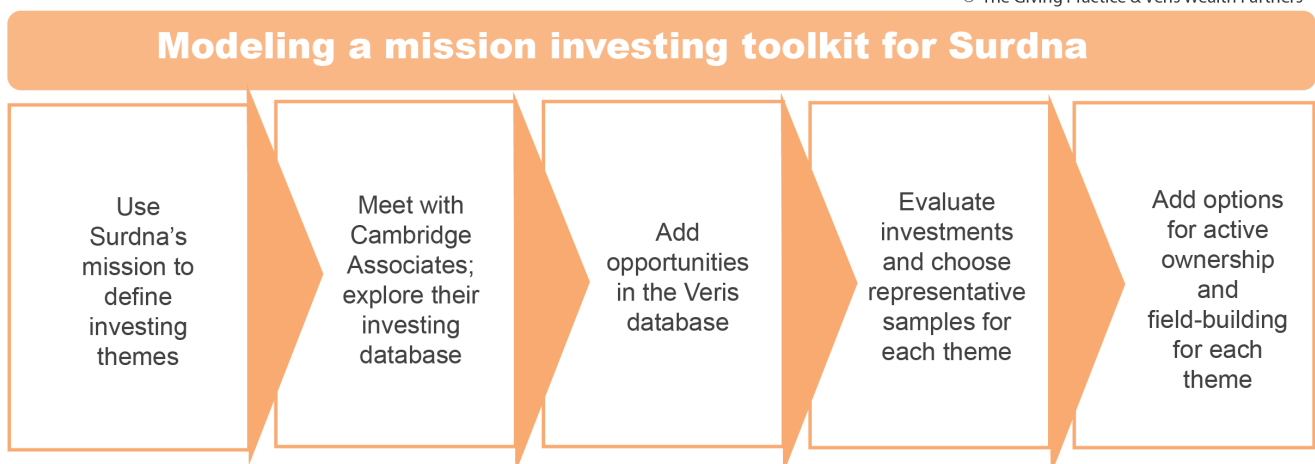
diverse interests helped ensure that Surdna’s exploration process was thoughtful, robust, and ultimately embraced by the entire Surdna community.

Hire a guide

In addition to the Foundation’s longstanding investment advisor, the board decided it was important to have an impact investing advisor who could serve in an educational role. Surdna released a request for proposals (RFP) through its networks, which explained that the Foundation was looking for time-limited support in leading an educational exploration – not a long-term engagement or a financial advisor. The staff reviewed responses from more than a dozen consultant teams and ultimately chose a consulting team that integrated approaches from two perspectives: Veris Wealth Partners, a wealth advisory firm that focuses on impact investing, and The Giving Practice, an organizational advisory group with a primary focus on collaborative inquiry. This partnership integrated a deep knowledge of social investing with a strong background in foundation strategies.

The consultants created the space the Foundation needed for learning and questioning assumptions. The guidance included offering examples of impact investing using a variety of tools, but not recommending specific investments. In other words, their emphasis was on educating, not advising.

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ON THE ROAD

Create a detailed itinerary

The learning journey reached six significant milestones over the course of the project, which the consultants developed into a roadmap with markers to summarize the steps along the way. Before every meeting, the Working Group reviewed the roadmap to reflect on what had been done and what was coming up next. This was very helpful for board members who could not be immersed in the impact investing exploration as a day-to-day activity.

The consultants interviewed all the board members and the program directors one-on-one at the beginning of the process to learn what they knew about impact investing and what questions they had. This helped create a shared language and highlighted important steps along the way.

“Early on it could feel like we were lost in a field of corn. As you learn, the paths become clearer.”

Stick to a schedule

Fixing time boundaries for the process helped everyone keep the pace. The Working Group scheduled meetings far in advance to maximize attendance. The board set aside time at three separate board meetings to hear what the Working Group was learning and discuss the implications. And perhaps most important, after the beginning of the exploration, the board held a retreat that included a discussion of the Working Group’s findings and a vote on moving forward. Instead of getting bogged down in wrestling data to perfection, everyone looked for “good enough” information that would keep the Group moving to the next step on time.

Follow paths forged by others

Some board members and staff who didn’t know much about investing – let alone impact

investing – came to the process hungry for more information. Staff and board members attended conferences hosted by Confluence Philanthropy and Mission Investors Exchange, which helped the Working Group and board members understand the size of the impact investing field.

A board and staff visit to the McKnight Foundation was also very enlightening. After Surdna decided to pursue impact investing, McKnight Foundation President Kate Wolford met with the board and offered encouragement “just as we were grinding through the details of a plan,” noted a board member. “Board and staff heard how it energized the whole [of McKnight], how great it had been.”

“Along the way I went to three convenings held by affinity groups. Each was an immersion in language and more, with cool people who made me comfortable talking in something that wasn’t my first language.”

By attending conferences on mission investing and visiting peers, staff and board members became more familiar with the territory and brought back their new knowledge and enthusiasm to the Working Group.

For those who preferred to be armchair travelers, the Working Group circulated a variety of readings.

What is ESG?

Environmental, social and governance (ESG) criteria is used by socially conscious investors to screen or prioritize investments. Environmental criteria examine how a company maintains or harms the natural environment. Social criteria look at how a company conducts relationships with its employees, suppliers, customers, and the communities where it does business. Governance addresses a company’s leadership, executive pay, shareholder rights, and audits and internal controls.

KEY MILE MARKERS

Framing what can be found in a foundation's impact investing toolkit

Having a common language about all of the potential tools Surdna could consider in its impact investing toolkit made exploration easier. It also helped everyone broaden their horizons on plausible impact investing approaches. The Working Group explored strategies like direct investment tools in the private market including PRI, investments in public equity funds with social criteria screens, active ownership strategies like shareholder engagement, and establishing criteria for selecting fund managers.

Learning what the Foundation already owns

It was crucial for the team to have a solid grasp of the criteria used by socially conscious investors to screen investments, including environmental, social, and governance (ESG) practices. This analysis and evaluation of the existing endowment, particularly the portfolio of the public equity and some of the alternative investments, were based on ESG criteria by the investment and external CIO consultants. In addition, a questionnaire went to every fund manager inquiring about their investment practices, including whether they integrated ESG factors. Also, at Surdna's request, the number of investment management firms and funds led by women and people of color was catalogued and compared to the total number in the financial advisor's universe of clients. The results were shared with staff and the board as well as the Working Group. The review helped Surdna understand what social and environmental criteria fund managers in its portfolio were already using and how those tools work. It also opened up an ongoing and spirited discussion about exemplary

and poorly reviewed investments and their implication for ownership at Surdna.

Creating values- and priorities-based impact investing themes

Throughout the process both board and staff were engaged in learning. Together, they identified themes that were most important to them both as individuals and as program teams. The consultants met with each program director to understand how an impact investing strategy could best meet Surdna's program goals. After synthesizing that information, the consultants identified patterns of agreement to suggest priorities and noted outliers for further discussion. By the end of the process, Surdna had identified four themes. Three of them were tied to its grant programs and a fourth addressed the racial/ethnic and gender diversity of fund managers.

Pressure testing the possibility of impact investing opportunities within each theme

Investment strategies in the toolkit – ESG strategies, direct investments, shareholder engagement, fund creation, and field-building – were considered in each of the program themes. The consultants and external CIO combed their respective databases for investment opportunities. The pressure testing involved looking at each investment from a financial return and social impact perspective. It included data about manager capacity and experience, diversity of ownership and management team, size of firm and fund, asset class, sector focus, fees, performance and impact criteria, and metrics. For many Working Group members, this process of creating hypothetical models changed how they thought about all the tools in the impact investing toolkit.

Exploring different paths for impact investing in an endowment to understand the implications

The Working Group and the board reviewed the pros and cons of four options:

- Do nothing and keep the existing investing practices;
- Apply impact investing to a dedicated portion of the endowment;
- Integrate impact investing across the portfolio; or
- Construct a hybrid approach of a carve-out and integration activities.

Since there is no single, “right” answer, the foundation focused on what would feel right given Surdna’s mission and strategies.

Detailing the operating implications of an impact investing program

To get a sense of the range of human and financial costs of impact investing, the consultants helped Surdna develop an initial checklist of staffing and operating practices to consider when working with its financial advisor on program implementation.

MISSION INVESTING STRATEGIES & TOOLS		
ESG STRATEGIES/ PUBLIC OFFERINGS	ACTIVE OWNERSHIP & MANAGEMENT	DIRECT INVESTMENT
Apply ESG screens to avoid negative mission outcomes	Shareholder engagement: + Vote proxies + Company dialog + File resolutions + Lead issue campaigns	Use ESG to invest in private companies (at market rate): + Invest via funds + Direct investments + Create a fund
Use ESG or sustainability criteria to invest for positive impact, or in solutions and market opportunities around ESG issues	Apply to mission criteria to manager selection and engagement process	Use ESG to invest in hard assets/alternatives (at market rate): + Invest via funds + Direct investments + Create a fund
Invest in companies and sectors where ESG and sustainability criteria add to business value and drive positive returns	Play field-building leadership and collaboration role	Program-related investments (below market rate): + Funds + Private companies + Social bonds + Guarantees
Integrate some or all mission investing tools across the whole portfolio		Establish a carve-out amount for some or all mission investing tools

ANTICIPATE BUMPS IN THE ROAD

Throughout the process, creative tensions naturally arose. Some were predictable and some were surprises. The key to addressing these speedbumps was to understand everyone's point of view and recognize that often the tensions had to be managed rather than solved. Here are a few examples.

Prepare to address diverging values

Surdna had refreshed its mission statement, including social justice goals, several years earlier, but impact investing raised the issue of the Foundation's values and priorities in a new way. As the discussion about potential themes tied to mission progressed, it surfaced the values each person held around certain kinds of investments and how each board member would weight or prioritize them if necessary. Working Group members diverged around the positive or negative implications of some investments and the possible use of negative screens and divestment strategies. Investment in fossil fuels, nuclear power, fracking, guns, and private prisons were among those that generated the most debate.

“The known is investing based on numbers. Trying to measure social impact is really fuzzy... for everyone.”

The consultants helped the board identify areas of common ground. The Working Group recommended that Surdna stay focused first on areas of agreement and explore negative screens and shareholder engagement options once impact investing was underway. Not everyone was happy with the decision, but it made forward momentum possible. As one member

reflected, “You can fracture on a topic if it comes up too soon. Don't be afraid to park it for a bit.”

Face the realities of ESG

The Working Group used ESG conventions to assess current investments. This was one of the most important moments in the process – and a challenging one. Not surprisingly, it is hard to look under the hood of an endowment with a purely analytic stance when values and personal perspectives enter the analysis.

At times, staff or board members, especially investment committee members, remarked that they felt uncomfortable or defensive about how certain investments were being assessed. Others felt the social assessment screens undervalued issues of significance to them or overemphasized metrics that were not as essential to Surdna. Additionally, the ESG screens did not necessarily cover all the impacts important to Surdna.

“We need to be shoulder-to-shoulder with those determining and measuring and reporting social value.”

The ESG evaluation prompted an important discussion about whether the Foundation should seek to improve a company's policies and practices as a shareholder or divest entirely instead. That in turn, opened up a discussion about whether the Foundation might help advance more research on social impact standards and metrics. And just as important, it helped the Foundation establish a policy to inquire into existing fund managers' approaches to social screens and ESG integration in the existing endowment.

Address the challenging questions

Working Group members also expressed concerns about how impact investing could upend a financial model that worked. Permission to express this concern was important because it led to productive conversations and essential

questions about the balance of investment performance and impact. How much financial performance is needed to support Surdna's current level of grantmaking? How much social impact is desired if it means giving up some financial performance? Is it possible to achieve social and financial goals simultaneously?

One Working Group member noted, "As we looked at a portfolio of investments we held, we started to ask, 'Are we having a bad impact in some areas and also, are we not maximizing impact in others?' Learning about this new territory makes me examine both sides of a coin: Is this a problem we have to solve and is there an opportunity here we have to take or miss out on something important?"

By the end of the journey, the Working Group had identified options for investments with both financial and impact returns, as well as additional impact investing strategies beyond investment. The Foundation also recognized a desire for varied risk-return profiles in the portfolio, including some investments (such as program-related investments) that are highly catalytic and sometimes carry new risks.

Strive for simplicity

Investment jargon, and especially impact investing jargon, is hard to parse and make plain. The consultants spent more time than originally planned finding language that was both accurate and easily digestible for those with a beginner-level understanding of finance. In the end, it was well worth the effort to have a shared language because it was a necessary prerequisite for collaborative conversations.

Working Group on Investment Policies and Practices: Statement of Purpose

Following the 2014 board retreat, the board charged the Working Group with the following tasks.

- Explore how investment policies and practices support and/or conflict with mission, core values, and program objectives.
- Build a board learning and decision-making process for responding to opportunities identified through exploration.

This Working Group aims, broadly, to identify the board's position on mission and investment alignment and then, if appropriate, identify changes to Surdna's current investment policies and practices. It will explore the Foundation's perspective on taking risks regarding investments and reconsider the policy that perpetuity is the sole investment metric.

The Working Group will engage experts on investing and mission-driven investing and collect information on the spectrum of existing investment practices and operational implications – including positive screens, negative screens, impact investing, racial and gender diversity of managers, and shareholder engagement. It will consider the relative impact of potential policies, with respect to our mission and values. In addition, it will consider the Foundation's role in field building and influence, alongside investments. Ultimately, the Working Group will develop recommendations on changing or affirming Surdna's investment policies and practices to bring to the board for deliberation and decision.

EXPLORATION CAN BE TRANSFORMATIVE

The journey opened everyone's eyes to the impact investing field, which is no longer nascent, but still far from mature. Opportunities to help the field grow are also appearing on Surdna's agenda.

The exploration process informed the decision to create a \$100 million mission-related investment allocation – including a program-related investment allocation – and to apply some impact investing tools across its entire portfolio. Beyond that decision, the board exploration process led to some unanticipated organizational impacts at Surdna.

Several board members commented that the investment committee often does the deep learning when it comes to endowment. A number of participants noted, "This process opened up learning for all."

Plus, participants ended up feeling more conversant about options in the impact investing toolkit in the context of the endowment. As one board member said, "During the exploration process an investment decision came up that we were not comfortable with, but we didn't have tools to work on it. Recently, it came up again and we decided to approach our investment with shareholder advocacy as well."

As another example, during the exploration process, the Working Group asked about the number of women fund managers and fund managers of color in the existing portfolio. After discovering the percentage was low, the board decided to ask the external CIO to actively seek

out both whenever there is a fund manager opening.

Impact investing is influencing other areas of the Foundation, too. As the program staff became curious about impact investing opportunities they reached out to their staff counterparts in other foundations to explore joint ventures. These discussions opened up the role that markets can play in achieving programs' social impact goals.

In addition, senior Foundation staff decided to invest in strengthening the impact investing field through grantmaking.

The impact investing journey isn't over for Surdna – in some ways, it's only just begun. The Foundation will continue to explore the role impact investing can play in all areas of the organization, and it's likely that program staff will influence impact investing and investment staff will influence grantmakers, creating a continuum and a more aligned approach. As one Working Group member said, "Using only one of the lanes available to us is not taking full advantage of the opportunity of philanthropy."

