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Impact Investing: A 21st Century Tool to Attract and Retain Donors

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Introduction

A familiar private foundation tool is being used by the Greater Cincinnati Foundation (GCF), a 50-year-old community foundation with nearly $500 million in assets, as a way to engage donor advisors to make a positive difference in the community.

Program-related investments, originally a tax-code device specific to private foundations, have for some years been adopted by community foundations as simply low-interest loans – an alternative to grants that ideally returns charitable capital to the foundation to be reinvested.

GCF has expanded its thinking about what are now typically called impact investments. They can go beyond traditional housing and community-development investments to investments that reduce a community's carbon footprint and create jobs. At the same time, the foundation can now offer donor advisors the opportunity to partner in these investments, recycling their donor-advised fund's charitable capital in a way that provides a social return in the community as well as a small financial return.

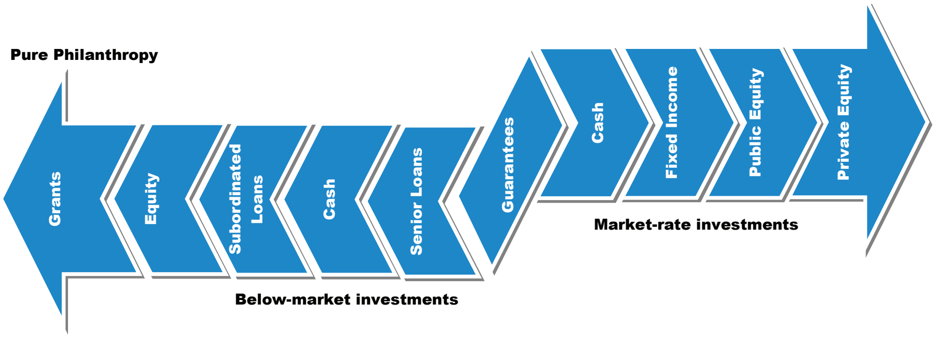
Key Points

- A familiar private foundation tool is being used by the Greater Cincinnati Foundation as a way to engage donor advisors to make a positive difference in the community.
- While due diligence and risk management of the financial return for these investments is crucial, the social return to be achieved is the primary consideration.
- Donors can achieve a modest financial return, which is recycled into their donor-advised fund, by investing locally in projects that make a significant difference.
- Initial donor interest in participating in impact investing has been strong and provided valuable insight into program design.
- The cost of an impact-investment program can be viewed as an investment in the community – much like a grant. If the individual investments are made carefully, the net effect should be a greater impact than grants alone can achieve.

Defining Impact Investing

The term "impact investing" is a relatively new term that means different things to different people. As the foundation started down this path,

FIGURE 1 Impact Investment Opportunity Continuum



GLOSSARY FOR FIGURE 1

Grant – Funds given to support a project or a nonprofit organization's work. (Grants have a negative 100 percent financial return and a very high degree of social return.)

Equity – An ownership interest in a business.

Subordinated Loans – Debt that has a lower priority than "senior debt." In a bankruptcy, senior debt would be repaid first, followed by subordinated debt.

Cash – May be in the form of a mission deposit in a community development bank or credit union.

Senior Loans – Debt that is paid first in a bankruptcy.

Guarantees – A formal assurance, especially in writing, to answer for the debt or default of another entity (e.g., a loan guarantee).

Fixed Income – Any type of investment that yields a regular (or fixed) return.

Public Equity – Equity capital invested in operating companies that are publicly traded on a stock exchange. (An equity investment may have a market-rate return, but little or no social return.)

Private Equity – Equity capital in companies that are not publicly traded.

Adapted with permission from F.B. Heron Foundation's Mission-Related Investment Opportunity Continuum in "New Frontiers in Mission-Related Investing"

an adaptation by Imprint Capital Advisors of F.B. Heron Foundation's Mission-Related Investment Opportunity Continuum was particularly helpful. As shown in Figure 1, the spectrum of philanthropic tools ranges from grants to tools that blend pure philanthropy and financial tools (offering a social return is paramount while providing some small financial return), to tools of the capital markets (providing a market rate return, but little or no social return).

The "Money for Good" initiative from Hope Consulting (2010) defines impact investing as opportunities that:

- allow you to put money towards an opportunity that creates a social or environmental benefit,
- attempt to return at least the principal invested,
- offer a return on your money (which varies by opportunity), and
- are not tax deductible.

The definition used by GCF's governing board is leveraging foundation assets to invest in local projects using loans and equity positions in addition to grants. As part of its mission as a community foundation, GCF's impact-investing efforts are geographically focused within the service area of the foundation.

Why Impact Investing for a Community Foundation?

According to Imprint Capital Advisors, the advantages of impact investing are:

- More efficient use of funds: investments that are repaid can be re-invested into more investments or given out as grants.
- Provid[ing] capital for critical community needs: for job creation, working capital to social services providers and arts organizations, and affordable housing loans when banks are retreating.

- Catalyz[ing] investment capital for the community: from donors, local financial institutions, national and local foundations. (Khor, 2010)

Through an impact investment, GCF may be able to see a more significant difference in the community sooner – simply due to the size of the investments. (GCF's average impact investment to date is $580,000.) If a grant was awarded for a community-development organization to purchase and renovate one house at a time, the timeline for a 24-house project might take six years. By using a larger low-interest loan from the foundation, the organization is able to continually acquire and renovate more houses. This orderly process for renovation will yield economies of scale in areas such as hiring contractors. The net effect is that the change in the community should be more obvious and more powerful when it can be accomplished at a broader scale and in a more concentrated time period.

Additionally, there are two business imperatives for community foundations to explore a donor-advised fund (DAF) impact-investing option at this time. First, DAFs have become commonplace in the philanthropic arena, offered by commercial providers as well as universities and other nonprofit entities. If community foundations are to remain competitive tools for giving, they must develop new products that are relevant to a broader range of donors. Second, community foundations hold billions of dollars in DAF assets that could potentially generate more social impact if they were unleashed in the form of investments (in addition to grants).

Laying the Foundation: Investment Experience at GCF

GCF made its first low-interest loan in 2002 as a "program-related investment" – then the *de facto* term even though it applies specifically to private foundations – to the Cincinnati Development Fund (CDF), a community-development financial institution and community-development loan fund. Using the foundation's unrestricted assets, this investment helped to lower the cost of developing a better mix of affordable and market-rate downtown housing units. A second loan was made to CDF in 2008 for a predevelopment fund to cover soft costs such as acquisition, architecture, and engineering in various neighborhoods.

GCF's investment with CDF introduced a new concept to the foundation's governing board. The financial return on these investments is typically not commensurate with the risk, a challenging concept for some board members with traditional business experience. Some were skeptical that any of that investment would be returned. Where a commercial financial institution tries to minimize risk and maximize financial return, a philanthropic organization making investments in support of its mission will work to maximize social return, minimize risk, and preserve capital. The foundation places less emphasis on the financial return.

The experience with CDF turned out to be very positive, with GCF receiving regularly scheduled repayments throughout the term of the loan.

The foundation's third such investment in 2009 was to the Local Initiatives Support Corporation (LISC) for community-development projects in the Greater Cincinnati region. This loan was the first made from a $5 million pool of unrestricted assets set aside by GCF's board for impact investing, launching a broad-based and sustainable program of community debt and equity investing.

An astute reader may ask about the effect of using unrestricted assets for impact investing. This is an excellent question. There are two main ways to handle the set-aside of unrestricted assets by either including or excluding those assets from the spending policy calculation. Each community foundation must select an approach based on local facts and circumstances:

> *Approach 1.* Include the assets set aside for impact investing in the annual spending policy calculation. There will be very little short-term effect on total funds available for grantmaking. But over time, the spending policy calculation will actually erode the

FIGURE 2 Strategic Grantmaking Framework

principal of unrestricted funds because assets used for impact investing are returning 1 percent to 2 percent, much less than the 8 percent market return historically assumed for a spending-policy calculation.

Approach 2. Exclude the assets set aside for impact investing from the spending-policy calculation. This protects assets from being "overspent" and diminished over time, but also results in lower amounts available for current grantmaking.

Community Investment Framework

GCF recently developed a new community-investment framework (see Figure 2), which defines where it will focus to make a difference in the community under the broad headings of Thriving People and Vibrant Places. The areas important to GCF include affordable housing, job creation, community stabilization and revitalization, educational success, access to health care, strong environmental stewardship, and cultural vibrancy.

The foundation does not have set criteria for assessing social return; it specifically and consciously works to align impact investments with grants in order to amplify and leverage results. Each investment opportunity's social return is evaluated individually to determine its potential impact on the community. An investment opportunity that encompasses multiple areas of the community-investment framework is viewed more favorably. For example, an investment in LISC revitalizes neighborhoods, improves access to affordable housing, and increases community safety.

GCF targets a financial return of 1 percent to 5 percent on its impact investments, although most often the return has been 2 to 3 percent. The financial return has to be balanced, though, with the length of the term of the investment. There is also interplay of the social return with the financial return. The foundation might take a lower financial return if the social return is quite strong, but might require a higher financial return if the social return is important but just "moderate" (e.g., the social return affects just one area of the framework).

Pipeline Development

In the initial stages of developing impact-investing policies, the foundation chose to focus on intermediaries such as community development financial institutions (CDFIs) – community-based lenders specializing in community development activities. These intermediaries undertake a rigorous process to attain the CDFI designation from the U.S. Department of the Treasury. Their goal is to bring capital into underserved communities. They are competent organizations with expertise in lending and working on investment opportunities in their local communities. GCF saw the practice of investing through intermediaries as a way to mitigate risk.

However, the foundation soon realized that the supply of CDFIs would quickly be exhausted. Even when the definition of "intermediaries" was extended to other types of organizations that receive and redistribute capital, the list in the foundation's geographic region was limited.

This realization led a newly formed impact investment committee to open the discussion of making direct investments in individual nonprofit organizations. In the end, the foundation still leans toward working with intermediaries because they have expertise in underwriting and making and servicing loans. They have policies and procedures in place and experience in this type of work. They tend to have protections in place, such as loan-loss reserves. GCF does not have comparable expertise in-house nor does it want to develop it. In fact, a grant currently under consideration would help a local CDFI build its capacity to act as the loan-servicing agent for three of GCF's impact investments.

GCF's *direct* investments in individual nonprofits are limited to established, well-run organizations that have experience with loans or equity investments and have the capacity and financial sophistication to manage them. Less than 1 percent of the region's nonprofit organizations have the ability to handle a direct investment. Following the success of its earlier program-related investments, GCF reached out to nonprofit organizations to promote the availability of this alternate method of funding. The foundation's program director had selective discussions with targeted organizations that fit within the parameters of GCF's community-investment framework. Once an organization understood what the foundation was looking for, the leaders could identify opportunities where they not only needed funds, but also had an income stream that could be used to pay off the loan. Outreach to nonprofit organizations adds time to the overall investment process. Negotiating the terms and identifying the collateral also takes time. Each situation is unique.

Due Diligence and Review Process
GCF's due diligence and review process has three phases. First, GCF's grantmaking committee reviews the social return of the impact-investment project. Using this committee for this purpose ensures consistency with the foundation's community investment framework. If there is no social return, then the project will not move forward. For example, GCF would not pursue an investment that solely improved the financial situation of a nonprofit organization, e.g., refinancing a line of credit at a lower rate, if it did not also have a direct community benefit.

The second phase is a high-level review by the impact investment committee, which conducts a preliminary analysis of the financial terms and structure of the proposed deal. Committee members were selected for their legal, banking and lending, and small business and entrepreneurial expertise.

GCF's consultants, Imprint Capital Advisors,[1] provide a summary memo at this stage. Imprint was selected for its unique proficiency in impact investing to outsource subject matter expertise and to further minimize the foundation's risk in these types of investments. If the opportunity looks promising as an investment, then Imprint will conduct a full due diligence review of the deal and produce a detailed report and recommendation for action at a second meeting (phase three) of the impact investment committee. This in-depth review process takes about eight weeks.

The process is iterative and nonlinear and does not always go exactly as "planned." GCF has needed to be flexible in moving investment opportunities through the process.

[1] www.imprintcap.com

A donor advised fund (DAF) acts like a charitable savings account – money set aside for future charitable use. When the money is given to a DAF, an income tax charitable deduction is granted.

The due diligence process for an impact investment is much more in-depth than the due diligence for an unrestricted grant. This is true for four reasons:

1. The scale of an impact investment is far greater than GCF's average grant size: average unrestricted grant is $40,000 compared to average impact investment of roughly $580,000.

2. The source of the impact investments is unrestricted principal. A failure would mean a permanent loss of assets, whereas grants are made from distributable income.

3. There is no expectation of repayment from a grant. An impact-investment project has to generate income to repay the investment, which requires additional due diligence to vet.

4. Impact investments made from a DAF where the donor relationship is a factor require even more risk mitigation to ensure a positive donor experience.

The success of impact investments is measured in accordance with social and financial metrics included in the term sheet of the agreements.

A New Idea

Following a presentation on impact investing by Judith Rodin, president of the Rockefeller Foundation, at a Council on Foundations conference in 2010, GCF President and Chief Executive Officer Kathryn E. Merchant began to consider whether GCF's success with program-related investments could be parlayed into a program that also included the foundation's donor-advised funds. The potential to invest additional capital into important community projects by investment-savvy donors appeared to be substantial. With $141 million in GCF's donor-advised funds at the time, if even 5 percent of the assets were invested in this way, an additional $7 million in capital would be available for community projects and could be recycled for future investments.

GCF received a grant from the Rockefeller Foundation to develop an impact-investing product for community foundations to use with their DAFs. Through the grant, GCF assessed the feasibility of a new DAF product, developed a prototype for Cincinnati, and created a free self-service toolkit and road map to help community foundations across the United States build their own programs. The toolkit is available from the Greater Cincinnati Foundation.[2]

Donor Input

In "Money for Good," Hope Consulting (2010) points out that impact investments are not tax-deductible. This is true for an impact investment made directly by an individual. An individual may loan money to a nonprofit organization, but doing so does not result in a tax deduction. However, by using donor-advised assets to make impact investments, the funds contributed have already received a deduction. When interest and principal payments are made, a pro rata share is repaid to the individual donor-advised fund. Since the fund is tax-exempt, there are no tax implications to the transaction.

GCF's key question for feasibility testing was whether donors would be interested in impact investment opportunities using DAFs. Three focus groups were held to test the idea. Two groups were comprised of donors to the foundation, while one was made up of nondonors who GCF staff thought might be interested in the idea (to test whether such a program might attract new donors). Based on affirmative feedback, a fourth and final discussion combined the groups to advise on program design.

[2] www.gcfdn.org/impactinvesting

GCF's consultant, Imprint Capital, facilitated each session. The groups received an overview of impact investing and examples including some of GCF's early ventures. Four possible models for donor participation in impact investments were offered for consideration:

1. Grants from DAFs to the foundation serve as the capital base for an evergreen impact investment fund, to be managed by GCF.

2. Donors create a standalone DAF just for impact investing. Donor funds are used for impact investments that further GCF's charitable purpose.

3. Impact investments serve as a pooled investment option (asset class) for existing or new DAFs, the proceeds of which the donor can use for his or her philanthropy.

4. Donors co-invest in specific impact-investment transactions, as presented by GCF, based on the donor's interests.

DAF Impact Investment Program Design

GCF incorporated these donor perspectives into the design of its program:

- In general, participants were intrigued by the idea.
- Participants believed the first three options were easier to administer and the most attractive to the foundation. However, the most appealing model for donor participation was to co-invest in specific impact-investment opportunities, better engaging donors based on their areas of interest.
- Participants emphatically said that the due diligence process is critical: "Make sure you have the professionals who can analyze the details – and not from a nonprofit perspective. You need expertise." Who participates in the due diligence process is key to its credibility with donors.
- Participants identified limits as important – either a minimum investment amount or a maximum percentage from a fund – in order to make a meaningful investment, maintain capital for active grantmaking, and be able to withstand a loss.
- There was a sense (but not universal agreement) that participants would be willing to take less than market return because of the social return generated.
- Focus group members voiced concern about the limited number of investable opportunities in GCF's geographic region.
- *How* opportunities are presented to donors is crucial. Participants advised GCF to "tout [the uniqueness of] it heavily and use it sparingly [take deals to donors only occasionally]."
- Participants stressed the importance of establishing a successful track record.
- They advised GCF to be very clear about the goal of impact investing. What is the foundation trying to accomplish? If it wants to be a change agent, then impact investing needs to connect to GCF's community-investment framework. Impact-investing efforts must be fully integrated with grantmaking and not a one-off activity.
- There was strong interest in making the impact-investment program available for nondonors to use.

GCF identified three goals for an impact-investment program for donor-advised funds:

1. Attract more capital (from DAFs) for investment in the local community.

2. Provide a new way to engage existing donors.

3. Attract new donors to the foundation.

Parameters guiding the participation of DAFs in impact investments are as follows:

- Deal-by-deal investment opportunities.
- Suggested limit of no more than 20 percent of a DAF's fund balance (unless the risk and overweighting is specifically acknowledged by the donor) in order to balance illiquid impact investing with donor's ability to suggest grants.
- Minimum investment varies by deal, but generally ranges from $10,000 to $50,000 per project.
- Interest paid to DAFs is 1 percent less than the deal's stated return to help cover the foundation's administrative expenses.

- As interest is paid to the foundation, the DAF receives its pro rata share.
- Upon repayment of the investment, principal is returned to the DAF.

Even though the focus groups had expressed strong interest in making impact investments available for nondonor participation, GCF opted to "crawl before walking." For the foreseeable future, GCF does not intend to offer this to nondonors (unless they become donors). To involve "other people's money" (e.g., a private foundation or DAF at another provider) in impact investing opens up many complexities, including being seen as providing investment services, which could trigger regulatory issues beyond GCF's scope and expertise.

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The way an opportunity is presented to donors is crucial. As the program took shape, foundation staff drafted materials for presentation to donors and a pitch to use in meetings. GCF convened a task force of donors to test the pitch and the materials before putting them into wider use. The foundation learned that it needed to:

- Sharpen the explanation of "social return" in written materials.
- Instead of leading with the contrast to a grant, lead with impact investing as a way to invest locally as an alternative to the stock market to achieve a social return, return of principal, and a small financial return.
- Emphasize its track record in getting repaid on impact investments.

Based on this advice, GCF staff refined and honed marketing materials.[3]

GCF analyzed donor grantmaking interests and activities, and concluded that a targeted segment of its 850-plus DAFs would find impact investing appealing. The foundation did not think the rollout of this program would be suited for a mass audience approach, so staff began having conversations with individual donors, one on one.

The conversation with potential impact investors, who at least in the early stages all had a DAF with the foundation, followed these key messages:

- Your donor-advised fund is invested – in stocks and bonds issued by corporations. What if a portion of the assets in your fund could be invested in our local community in a way that will have a social return, a return of principal, and a small financial return? After the term of the investment, the assets are available for reinvesting in something else or for granting to your favorite nonprofit. Would you be interested?
- What a great way to "recycle" your charitable dollars and make your giving go even further. When you make a grant, you do great things, but the money is spent and gone. This approach enables your fund to get it back and do more good.
- It's flexible – you pick in which deals you want to invest – along with GCF, which has a proven track record of managing investments like this in this community.

The foundation saw success almost immediately with this approach. The first three donor conversations yielded two impact investments and a commitment for another if GCF could offer an opportunity in education in the next two years.

Based on the earlier focus groups, the foundation's hypothetical best prospect for impact investing was a 50-something, entrepreneurial-

[3] Current versions of all marketing materials may be viewed at www.gcfdn.org/impactinvesting.

type donor. As it turned out, these first three investors were all older than 70, debunking the original hypothesis. One donor, a former corporate CEO, readily agreed to "try out" the new opportunity and allowed the foundation to pick the investment deal. He said he trusted GCF's judgment and its process and was very complimentary about the work that the foundation does and the things it has asked him to support in the past. His initial reaction, when told that the target timing for an investment would be five to seven years, was "I'm 71 and seven years feels like a long time." That comment caused GCF to reduce its target investment time horizon to three to five years.

The other early adopter was an attorney who has had a DAF since 1986, but does not actively use it. Since he'd participated in the focus groups, a staff member closed the loop with him by providing an update on the impact-investing program. In that conversation, he quickly offered to invest with GCF to put the fund to work while it was not being actively used for grantmaking. In his case, and with approval of the chair of GCF's impact investment committee, the foundation made its first exception to the suggested limit of DAF impact-investment participation to 20 percent of a fund's value. GCF requested that the donor formally acknowledge that the investment exceeds the suggested limits.

Within eleven months, GCF's donor advisors had allocated more than $400,000 toward the foundation's impact investments. Reasons given for their participation include that they:

- want GCF to be a leader in improving the community and that alone is an important enough reason to support this effort,
- like the idea of supporting tangible development activities and then recycling the investment for future opportunities,
- like that the investment opportunities are integral to making Greater Cincinnati a better place, and
- have enough funds available to put a portion of them to good use in helping our community while they are not actively using them for grantmaking.

Some of the reasons given by donors who have opted not to invest in deals include not seeing a deal in which they are interested (yet), or it simply not fitting with their family's giving model. They were not opposed to the concept.

One new DAF has been created because the donor was strongly influenced by the new program. Several other prospects are seriously evaluating setting up DAFs specifically for impact-investing purposes. GCF will likely waive the suggested maximum investment percentage requirement in those cases (with written donor acknowledgment).

With the first investors ready to participate, GCF developed a disclaimer and acknowledgment form. The document covers the following points and is signed by both the donor advisor(s) and GCF:

1. GCF makes the final investment decisions.

2. The investment returns, success, and return of funds are not guaranteed.

3. GCF is not marketing or selling securities or recommending any particular impact-investment project to donors. (Note: GCF is simply presenting options to donors, as is the case for investment firm options when a fund is established or options for grant opportunities in a donor's areas of interest.)

4. The funds in any impact-investment project will remain illiquid for the duration of the project.

Staffing and Costs

Buy-in and leadership from the CEO is a key element to adopting impact investing. Although outsourcing the financial due diligence to experts is key to the foundation's stewardship, knowledge of the local nonprofit community and the ability to judge social return is resident in GCF's grantmaking staff. The foundation's program director is well versed in the vocabulary of these investment opportunities, as well as the landscape of nonprofit organizations working on large-scale community issues, from a decade working as a corporate grantmaker and veteran community volunteer. The involvement of finance

Examples of Impact-Investment Opportunities Offered to Donors

Home Ownership Center of Greater Cincinnati (HOC): A 3 percent, $430,000 loan helped buy back 34 mortgages HOC had originated and was servicing but that were now owned by Wells Fargo. After HOC bought these performing mortgages for 52 cents on the dollar, they will continue to service them, leveraging personal relationships with the low-income homeowners to navigate personal challenges and these complex subsidized mortgages. The investment promotes strong neighborhoods by preventing foreclosures.

Greater Cincinnati Energy Alliance (GCEA): A 3 percent, $500,000 investment in GCEA's loan pool offers 6.99 percent unsecured loans to homeowners to pay for energy-efficient retrofits. The goal is to help homeowners lower energy usage and save money, in turn reducing the Greater Cincinnati region's carbon footprint. The savings are sufficient for the homeowner to repay the loan. This readily available capital will also generate new jobs in the region as contractors increase their staffing to meet demand.

Finance Fund of Ohio: A 3 percent, $500,000 investment in a loan pool for community-based health centers for equipment (especially dental) and expansion. The health centers will pay off their loans through increased private-pay/self-pay and government insurance. This investment is bolstered by two private foundation investments and a GCF grant to help strengthen the fund's capacity to underwrite these health care loans. Nationally, 56 percent of children with Medicaid do not have access to dental care and, as a result, don't have routine check-ups. This investment will help build the region's access to dental care as well as primary care services.

Other types of deals include:

- Gap financing for commercial and residential real estate development in urban core communities (social return: diverse housing mixed with commercial opportunities for residents and visitors).
- Seed funding (to match state of Ohio Third Frontier dollars) for startup businesses in information technology, bioscience, and advanced manufacturing (social return: creation of 1,000 new jobs by 2017).
- Seed funding for a "patient capital" loan fund to grow sizable competitive minority-owned businesses (social return: grow eight to 12 companies and create 250 jobs in three years).

staff has been critical in tracking the terms and details of the financial aspects of the investments. Donor-relations staff has been actively involved in explaining and recruiting donors for participation in investments. Communications staff has been integral in developing the messages and materials to support these efforts. The cross-functional nature of this effort is viewed by veteran staff as the best example of breaking down silos seen during their tenure.

An effective impact-investing program also requires a significant commitment of time and money. There are embedded and real additional costs for planning and program design, pipeline development, deal due diligence, legal work, and donor cultivation, as well as extensive operational staff time required across departments. The cost underscores the importance of achieving social return and parallels the cost of awarding a discretionary grant or series of grants to make a difference in the community. If impact investments are made carefully, the net effect should be a greater impact than grants alone can generate.

Part of the cost for GCF is "going the extra mile" to ensure successful deals and to build confidence for donors to participate with the foundation. A cost-benefit analysis shows that the more effort put into minimizing the risk and making a deal airtight, the higher the cost but the higher the potential for financial return. Balancing the financial cost of due diligence with the level of social and financial return is critical.

For GCF, the annual cost for consulting will likely be $75,000 to $125,000, based on the amount of invested assets. Imprint Capital provides oversight and reporting for the program as well as high-quality due diligence work for individual investment opportunities. The consulting and staff-time costs are partially offset by GCF's retaining one percentage point of a deal's stated return for its operating budget. Legal costs at this stage are about $4,000 per investment and are passed through to the borrower as a closing cost. While this may seem unusual, it is a standard cost that any nonprofit would incur by taking out a loan from a commercial bank. Any additional support provided through GCF's operating budget is a strategic decision intended to yield a social return.

The foundation must and will continue to look for ways to reduce the time-intensive nature of the effort, including donor communications.

Conclusion

GCF has been pleased by the early positive response from donors who see the opportunity to participate in an impact investment as innovative and creative. GCF set a "stretch goal" of $1 million in DAF participation in impact investments by the end of the first full year.

In developing the pipeline of investable opportunities, GCF found that nonprofit organizations, even intermediaries, sometimes need help to be able to manage debt and equity. A companion goal of the foundation's impact-investment program is to grow the capital absorption capacity (Wood & Grace, 2012) in the region. Having strong, well-established intermediaries will make it easier for other foundations to move into this space. Therefore, building the operational capacity of nonprofits is critical. The foundation has set aside a portion of its discretionary grant budget specifically to make capacity-building grants to these entities. The grants may be used to either build the capacity of the nonprofit borrower or to provide technical assistance to an intermediary's borrowers. One example is to expand the capacity of an existing statewide CDFI to make loans in a new sector by providing training for their staff.

Some key questions for a community foundation evaluating the potential of establishing an impact-investment program include:

- Does the foundation have experience making impact investments using its own unrestricted funding?
- How deep is the local pipeline of investable deals?
  - What is the strength and availability of intermediaries?
  - How strong are local nonprofits?
  - What additional capacity might need to be added to either intermediaries or directly with nonprofits in order to make an impact investment?
- How much expertise does the current staff have? What would need to be contracted or added, and at what cost?
- What is the appetite for such a program with the community foundation's board and among donors?
- Who would be local competition?

Potential risks should be evaluated and each community foundation needs to determine if the risks can be mitigated in a satisfactory manner. Some possible risks and mitigants from GCF's perspective include:

- Financial loss. As with any investment, there is a risk of loss. This can be mitigated by a strong due diligence process. However, the more thorough the process, the more expensive, so it is important to strike a balance that is comfortable to the foundation.
- Donor relations. "Early wins" and positive experiences with investments will engender donor enthusiasm. Complete disclosure and education can help to set expectations about the risk of loss and illiquidity during the term of the investment. Emphasis on social return as the main factor in deciding to participate is critical since the financial returns are generally below-market. Highlighting investment opportunities consistent with donors' grantmaking interest also may help to lessen the disappointment if a loss turns an investment into a grant.
- Regulatory issues. Since the assets involved in impact investments belong to GCF (and outsiders are not participating unless they first become donors), GCF is not marketing an investment in a regulatory sense. The disclaimer form reinforces that.

While the creation of a program of impact investments using both unrestricted and donor-advised assets has been a rewarding and exciting experience, it is a journey to be taken with full understanding of the costs and benefits.

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