

Mission-Driven, Program-Related Investing: SRI Strategies for Small Institutions

Kimberly Griego-Kiel, AIF®, President

Johann Klaassen, PhD, CFP®, AIF®, Chief Investment Officer

Horizons Sustainable Financial Services, Inc.



HORIZONS
SUSTAINABLE
FINANCIAL
SERVICES

Disclosure / Disclaimer

Kimberly Griego-Kiel is an ACCREDITED INVESTMENT FIDUCIARY™, the professional designation certifying competency in the area of fiduciary responsibility. Kimberly is Licensed in the following states; AZ, CA, CO, CT, DC, FL, HI, IN, KY, LA, MA, MD, ME, MI, MN, MO, NC, NM, NY, OH, OR, TX, VT, WA, WI, WY.

Johann Klaassen is an ACCREDITED INVESTMENT FIDUCIARY™, the professional designation certifying competency in the area of fiduciary responsibility. Johann is also a CERTIFIED FINANCIAL PLANNER™ certificant.

Horizons Sustainable Financial Services, Inc., is a Registered Investment Advisor that is incorporated and registered in the State of New Mexico. In accordance with federal law, we may only conduct business in states where appropriately registered or exempted from registration. We currently serve clients in a number of states nationwide, and would be pleased to discuss whether it is permissible (given your state of residence or incorporation) for us to serve your financial needs.

We do not personally own any shares of any of the specific companies we might mention in the course of this presentation.

Nothing in this presentation should be interpreted as investment advice, or as an offer to buy or sell securities.

Any performance figures contained herein are based on information sources believed to be reliable, and are not to be interpreted as a guarantee of future results.

Asset allocation and diversification strategies cannot assure profit or fully protect against loss. Indices mentioned are unmanaged and cannot be invested into directly.

Purpose of Session

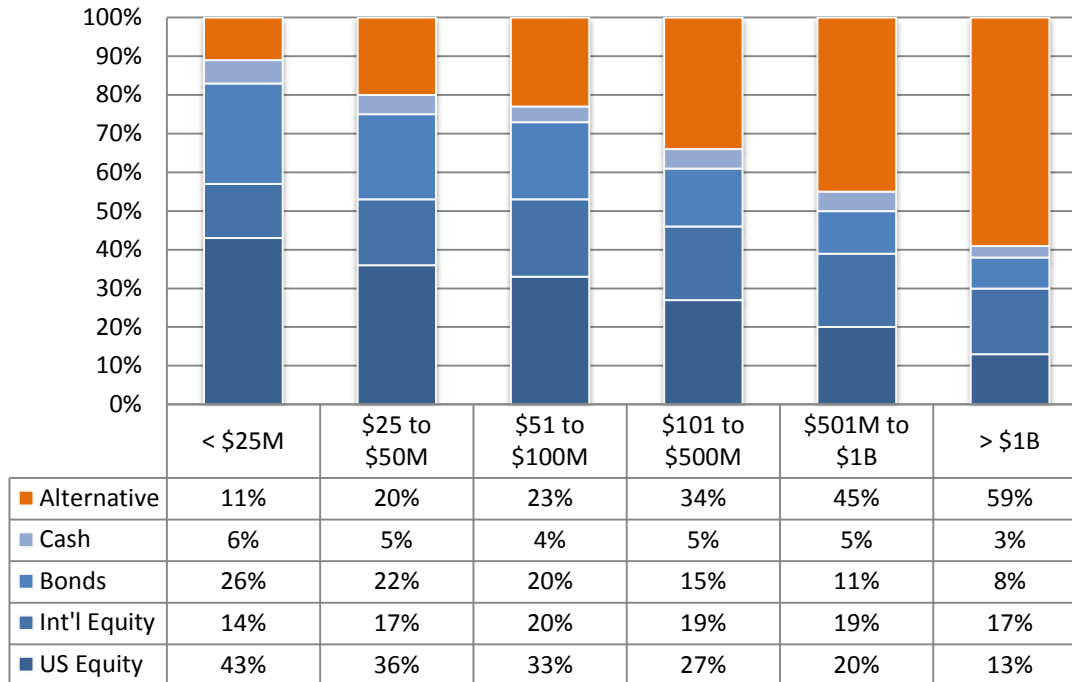
Many smaller institutions (foundations, endowments, and the like) have a desire to invest their assets in a way that aligns with the core mission they were formed to serve and promote. But all too often the stewards of these institutions are worried that they can't pursue SRI strategies in their investment portfolios.

Purpose of Session

In this session, we will (A) discuss how to allay the institutional stewards' fears, and demonstrate to them that they can, in fact, pursue mission- and program-driven investment strategies – and (B) discuss how to invest the assets of a small institution for increased social and financial impact, offering some detail on some of the mission-driven SRI investment strategies that can be used to build prudent portfolios for smaller institutional clients.

How Are Institutions Investing?

2013 NACUBO - Commonfund Study



“Alternative strategies are categorized in the NCSE as follows: Private equity (LBOs, mezzanine, M&A funds, and international private equity); Marketable alternative strategies (hedge funds, absolute return, market neutral, long/short, 130/30, and event-driven and derivatives); Venture capital; Private equity real estate; Energy and natural resources (commodities, managed futures); and Distressed debt.”

<http://www.nacubo.org/Documents/Endowment%20Files/2013NCSEPublicTablesAssetAllocations.pdf>

SRI Investing?

- Screening
 - Public Markets
 - Negative Screening
 - Positive Screening
- Shareowner Advocacy
 - Public Markets
 - Engagement with Management
 - Proxy Participation & Voting
- Community
 - Market-Rate Debt
 - Below-Market-Rate Debt
 - Equity
- Impact
 - Private Equity
 - Private Debt
 - Mission- or Program-Related

Money holds power.

There is a key component of Sustainable, Responsible, Impact Investing that brings light to that power. By leveraging the economic influence of the more than \$3 trillion invested by regular people like you and me, we can be a major catalyst for change in our world.

Worries about SRI

Some Investment Stewards understand that they have fiduciary duties ... and so have worries about using SRI strategies:

- Performance Worries
- Fiduciary Breach Worries
- Effectiveness Worries

SRI: Performance Worries

Per www.msci.com:

The **MSCI KLD 400 Social Index** comprises companies with high Environmental, Social and Governance (ESG) ratings and excludes companies involved in Alcohol, Gambling, Tobacco, Military Weapons, Civilian Firearms, Nuclear Power, Adult Entertainment, and Genetically Modified Organisms (GMO). The Index aims to serve as a benchmark for investors whose objectives include owning companies with very high ESG ratings and avoiding companies that are incompatible with specific values-based criteria. Launched in May 1990 as the Domini 400 Social Index, it is one of the first Socially Responsible Investing (SRI) indices. Constituent selection is based on data from MSCI ESG Research.

April 25, 2014

Cumulative Index Performance — Gross Returns (Mar 1999 – Mar 2014) — USD



Index Performance — Gross Returns (%) (March 31, 2014)

	1 Mo	3 Mo	1 Yr	YTD	Annualized			
					3 Yr	5 Yr	10 Yr	Since Apr 30, 1990
MSCI KLD 400 Social Index	0.29	2.03	22.88	2.03	15.50	21.11	7.20	10.40
MSCI USA	0.69	1.84	22.05	1.84	14.72	21.27	7.61	9.96

Index Performance — Gross Returns (%) (March 31, 2014)

	1 Mo	3 Mo	1 Yr	YTD	Annualized			
					3 Yr	5 Yr	10 Yr	Since Apr 30, 1990
MSCI KLD 400 Social Index	0.29	2.03	22.88	2.03	15.50	21.11	7.20	10.40
MSCI USA	0.69	1.84	22.05	1.84	14.72	21.27	7.61	9.96

Fundamentals (March 31, 2014)

Div Yld (%)	P/E	P/E Fwd	P/BV
1.80	20.38	16.78	3.08
1.99	18.30	15.69	2.67

Index Risk and Return Characteristics (March 31, 2014)

	Turnover (%) ¹	Annualized Std Dev (%) ²			Sharpe Ratio ^{2,3}				Maximum Drawdown	
		3 Yr	5 Yr	10 Yr	3 Yr	5 Yr	10 Yr	Since Apr 30, 1990	(%)	Period YYYY-MM-DD
MSCI KLD 400 Social Index	20.97	12.11	13.92	14.66	1.24	1.44	0.42	na	53.71	2007-10-09—2009-03-09
MSCI USA	2.51	12.58	14.07	14.76	1.14	1.43	0.44	0.48	54.91	2007-10-09—2009-03-09

¹Last 12 months

²Based on monthly gross returns data

³Based on BBA LIBOR 1M

SRI: Fiduciary Breach Worries

From time to time attorneys and investment advisors serving on the Finance Committee of non-profit boards ask about their fiduciary duty:

“Isn’t it contrary to our duty to allow any narrowing of the universe from which our managers can choose?”

Practice SA-2.7

The IPS defines appropriately structured socially responsible investment (SRI) strategies (when applicable).

- Consider the purpose and mission of the organization
- Make sure social and fiduciary responsibilities are aligned through proper implementation and monitoring

Practice SA-2.7

The IPS defines appropriately structured, socially responsible investment (SRI) strategies (where applicable).

- 2.7.1 The purpose and mission have been evaluated to determine whether socially responsible investing is appropriate and/or desirable.
- 2.7.2 If a socially responsible investment strategy is elected, it is appropriately structured, implemented, and monitored.

Department of Labor: 1998

PWBA Office of Regulations and Interpretations
Advisory Opinion 98-04A, May 28, 1998

“[T]he fiduciary standards of sections 403 and 404 do not preclude consideration of collateral benefits, such as those offered by a 'socially responsible' fund ... if the investment offering the collateral benefits is expected to provide an investment return commensurate to alternative investments having similar risks.”

The Freshfields Report: 2005

“The links between ESG (environment, social, governance) factors and financial performance are increasingly being recognized. On that basis, integrating ESG considerations into an investment analysis is clearly permissible and is arguably required in all jurisdictions.”

“Far from preventing the integration of ESG considerations, the law clearly permits and, in certain circumstances, requires that this be done.”

http://www.unepfi.org/investor_law/freshfields_legal_resp_2005.pdf

SRI: Effectiveness Worries

One final argument we hear —

“Okay, fine, we could do this. But it’s an awful lot of effort to go to, and won’t actually make a difference in the world.”

Effectiveness

Screening

Carbon energy divestment campaigns are picking up steam across the country ...



Advocacy

Our partners at As You Sow, for example, filed resolutions with more than a dozen companies in 2013.



Effectiveness

Community

Fahe is a CDFI which has used about \$100 million in loaned capital to create and preserve about 77,000 affordable homes across Appalachia.



Impact

PE / PD deals can help convert farmland to organic methods – and help get local organic produce to consumers.



Enough Argument — Let's Take Action!

So, say we convince an Investment Committee to engage with an SRI investment strategy.

What do we actually recommend?

Resources: Public Equity

Screening:

- What screens — positive and negative — are best for the client? What are their institutional commitments?
- Can the managers selected for the portfolio work within the restrictions these screens impose?

Resources: Public Equity

Shareowner Advocacy:

- Are there some securities that the client would like to own and use for advocacy purposes, rather than exclude?
- Can the managers selected for the portfolio engage — dialog with corporate management, file or co-file resolutions, vote proxies?

Resources: Public Debt

Bonds – Screening:

- Bond portfolios should be screened as closely as equity portfolios — the same sort of criteria can be applied.
- Can the managers selected for the portfolio work within the restrictions these screens impose?

Resources: Public Debt & Cash Equivalents

Community Investments:

- There are a wide variety of CDFI instruments available, most of which resemble short-term bonds or CDs.
- Can the managers selected for the portfolio use these instruments in building the client's portfolio?

Resources: Public Debt & Cash Equivalents

The Forum for Sustainable and Responsible Investment (“US (SIF)”) has recently produced a report on new efforts in community development & investment:

http://www.ussif.org/files/Publications/USSIF_Expanding_Markets.pdf



Resources: Public Markets

Hiring “hotshot managers” with no significant experience running SRI portfolios, and providing them with a client’s SRI criteria to use as an overlay on their normal process, tends to bring disappointing results.

Instead, we focus on hiring a manager that has long experience with SRI, prudent processes, and a good track record.

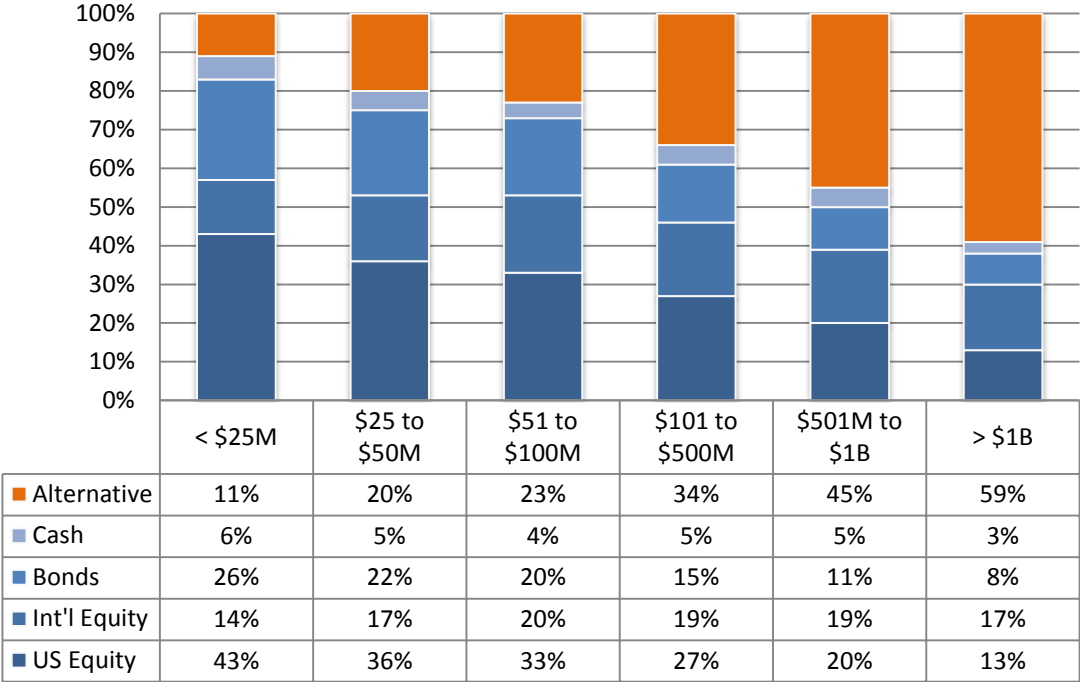
Resources: Public Markets

The Forum of Sustainable and Responsible Investment maintains a database of separate account managers in SRI:

<http://charts.ussif.org/sam/>

How Are Institutions Investing?

2013 NACUBO - Commonfund Study



“Alternative strategies are categorized in the NCSE as follows: Private equity (LBOs, mezzanine, M&A funds, and international private equity); Marketable alternative strategies (hedge funds, absolute return, market neutral, long/short, 130/30, and event-driven and derivatives); Venture capital; Private equity real estate; Energy and natural resources (commodities, managed futures); and Distressed debt.”

<http://www.nacubo.org/Documents/Endowment%20Files/2013NCSEPublicTablesAssetAllocations.pdf>

Resources: Impact

Private Equity & Debt:

“Alternative investments have become one of the most dynamic segments within the ESG investing space. Alternative investment funds include social venture capital, double or triple bottom line private equity, hedge funds and property funds. The US SIF Foundation identified an estimated \$132 billion in capital under the management of 301 alternative investment funds at the start of 2012, up dramatically from the \$37.8 billion it identified in 177 funds just two years earlier.”

Resources: Impact

“Money & Impact Investing Directory”

“There are a growing number of terms to describe and connect the resources, including impact investing, responsible business / investing, social finance, and slow money to name a few. Each has its place in creating a new economy based on more long term values that include knowing where our money goes.”

<http://impactinvestingdirectory.com/>

Resources: Impact

“ImpactAssets 50”:



“This annually updated list is a gateway into the world of impact investing for investors and their financial advisors, offering an easy way to identify experienced impact investment firms and explore potential investment options. The IA50 is intended to illustrate the breadth of impact investment fund managers operating today. Happily, there are more than 50 top tier impact investment funds in the world — which means not all are included in the IA 50. These 50 firms have been selected to demonstrate a wide range of impact investing activities across geographies, sectors and asset classes.”

http://www.impactassets.org/publications_insights/impact50

Resources: Impact

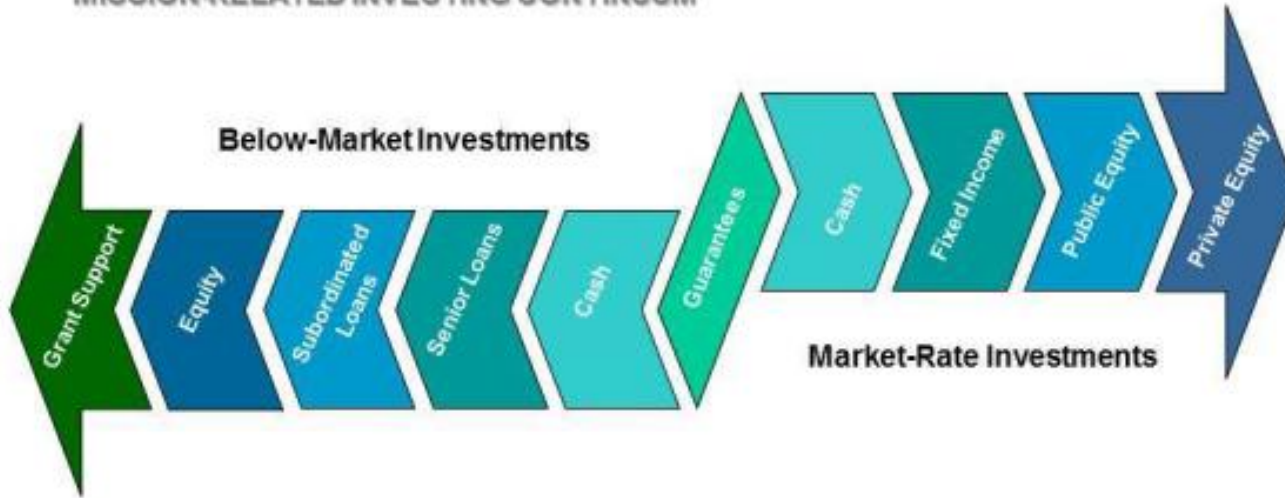
www.ImpactBase.org:



“ImpactBase provides players in the industry (such as individual investors, foundations, endowments, financial advisors and consultants, family offices, private bankers and development finance institutions) an efficient and organized mechanism for finding the information needed for the impact investing industry to succeed. On ImpactBase, impact investors – both experienced and new – can search for funds that may fit with their impact investment interests and objectives. ”

Resources: Impact

THE F.B. HERON FOUNDATION
MISSION-RELATED INVESTING CONTINUUM



Program-Related, or Mission-Related?

<https://www.missioninvestors.org/>

Resources: Impact

Mission-Related:

“Mission-related investments (MRIs) are investments that seek to achieve specific social and/or environmental goals while targeting market-rate financial returns comparable to similar non-mission focused investments. MRIs are not an official IRS designation, and are conventionally distinguished through the explicit targeting of social benefits. Opportunities for MRIs exist across asset classes and issue areas.”

Resources: Impact

Program-Related:

PRIs emerged as a formal philanthropic activity in response to the Tax Reform Act of 1969. The law cautioned private foundations against making any investment that could imperil its ability to generate funds needed to support its charitable activities. However, under Section 4944, private foundations are allowed to make “program-related investments” that may generate limited or no financial return, provided they met three criteria:

- The primary purpose of the investment is to accomplish one or more of the charitable, religious, scientific, literary, educational and other exempt purposes.
- No significant purpose of the investment is the production of income or the appreciation of property.
- No purpose of the investment is to lobby, support or oppose candidates for public office or to accomplish any of the other political purposes forbidden to private foundations.

MRIs vs. PRIs - Foundations

PRI Examples

- Affordable Housing
- Loan to Nonprofit to Expand Operations
- Equity Investment For Profit Company with Mission

PRI Vehicles

- Low interest loan
- Credit enhancement
- Equity investment
- Line of credit
- Mortgage financing
- Interim financing

Case Study – Alliance Center

Current Financing

- 4.5M Mortgage @ 3.58%
- \$3M Grant Gap Renovation

PRI Refinance 1%

- ~\$4.6M Total Savings



From the Press Release:

Denver, CO (January 30, 2014) – The Alliance for Sustainable Colorado announces receipt of a \$7.5 million Program Related Investment (PRI) made through a donor-advised fund of The Denver Foundation. The Alliance is using the loan, with a highly favorable interest rate, to invest in LEED platinum renovation of the Alliance Center, a 100-year old, a multi-tenant nonprofit building in Lower Downtown Denver.

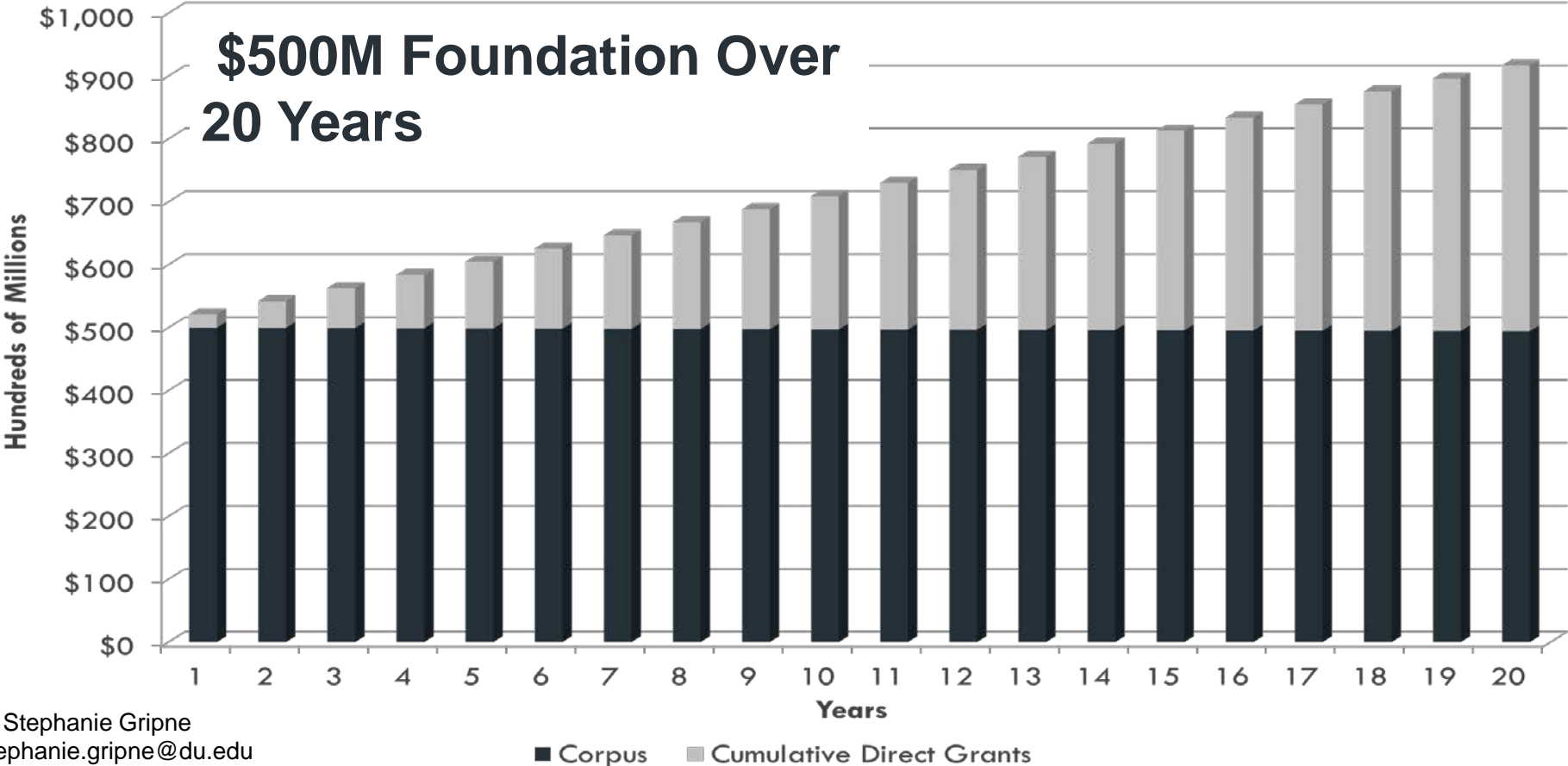
From the Press Release:

As a result of this PRI, the Alliance may complete the renovation of the Alliance Center, creating the 21st century workspace and sustainability hub for Colorado. In addition, the case study of this PRI will contribute to the National PRI | MRI Research Project, the first of its kind being conducted by the University of Denver's Impact Finance Center.

— <http://www.sustainablecolorado.org>

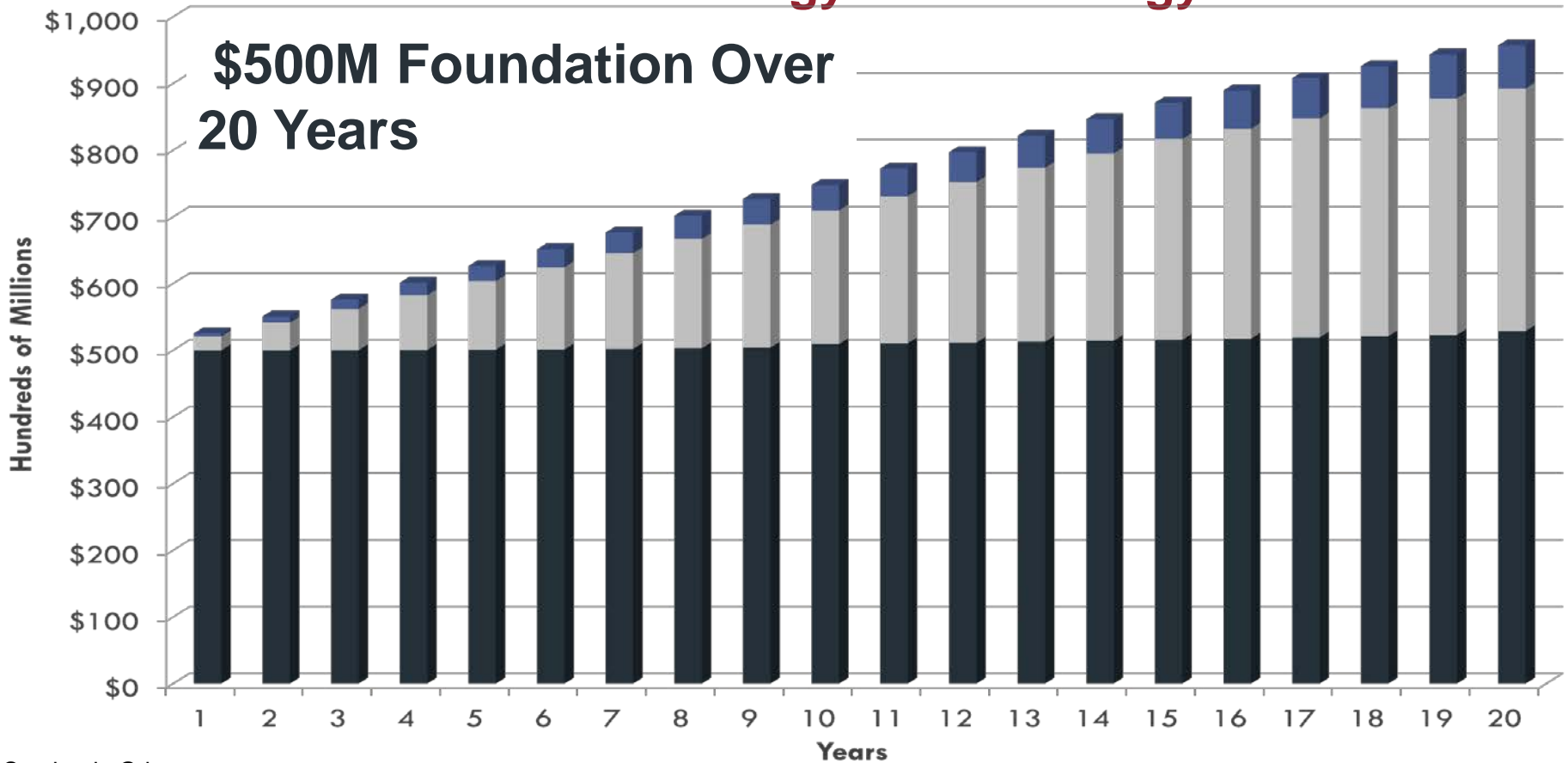
How a Foundation Benefits

Foundation Strategy No PRI Strategy



How a Foundation Benefits

Foundation Strategy – PRI Strategy

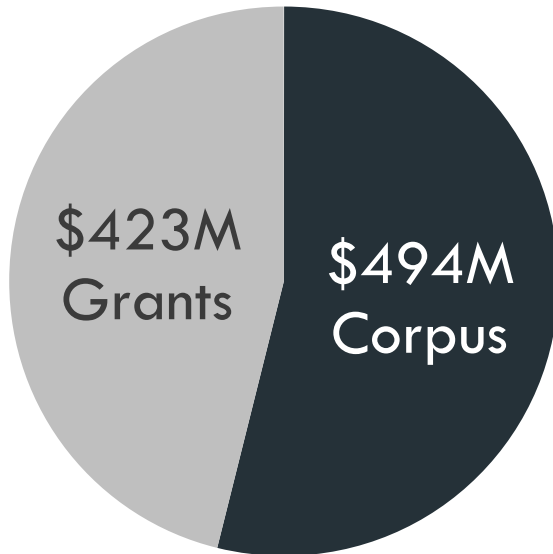


How a Foundation Benefits

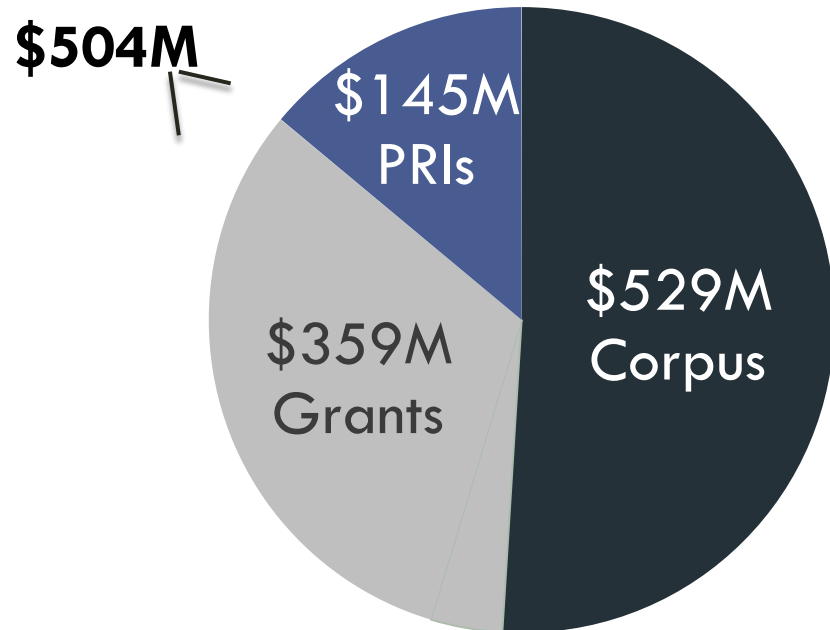
Foundation Strategy No PRI vs. PRI

5.2% Return Corpus

No PRI Strategy



PRI Strategy



Resources: Impact

Mission Investors Exchange has a terrific 25-page guide to PRIs, available for free download from their website.

<https://www.missioninvestors.org/>

**PROGRAM-
RELATED
INVESTING
SKILLS & STRATEGIES
FOR NEW
PRI FUNDERS**

Summary

Small institutions may – and perhaps must – invest their assets to reflect their institutional missions.

The stewards of these institutions may not believe this, but can be convinced.

The best approach is to hire managers who have expertise in working with SRI clients.

There are a variety of resources available to find these managers.

Contact Us

Kimberly Griego-Kiel

Kim@HorizonsSFS.com

505.982.9661

877.321.2326

413 Grant Avenue, Suite B

Santa Fe, NM 87501

Johann Klaassen

Johann@HorizonsSFS.com

719.262.0725

P.O. Box 836

Palmer Lake, CO 80133

