The Guardian Charity Investment Conference
3 October 2002
Managing Risk in Volatile Times

PROGRAMME RELATED INVESTMENT – SHOULD CHARITIES INVEST IN THE COMMUNITY AS WELL AS IN THE MARKET?

Introduction

The invitation from the Guardian asking me to round off a conference on charity investment came as something of a shock – not least because it arrived in the same week that I was reported in the charity press as having said at a community finance conference that 'the problem with endowed trusts and foundations is that their endowment, their asset, is managed by hard-boiled businessmen but their income is distributed by bearded Guardian readers'. If a platform like this is a reward for such abuse I had better think up some more!

The quote, however, is relevant to what I'm going to talk about this afternoon. It refers to the lack of any connection in most endowed charitable trusts and foundations between, on the one hand, the policies, priorities and values that shape how they use their resources and funds to support charitable activity and, on the other, their strategy for the investment of that endowment. In almost all Trusts and Foundations, these two tasks are kept entirely separate – the investment strategy concerned with generating a financial return – typically aiming to "protect and, if possible, enhance the real value of the capital and the income"; the grants using the latter to support charitable endeavours. There is seldom any focus within the investment strategy on outcomes that have any direct relevance to the objects and purposes of the charity; and – even more seldom – any consideration of whether or not the trust or foundation could do anything with its funds another than making grants.

Trusts and Foundations – Difficult Times

One outcome of the current volatility which provides the title for today's conference is that endowed trusts and foundations are facing difficult times and a sizeable cut in their wealth – and, potentially, of their capacity to support charitable activity.

It's not just the fall in equity values that's creating these difficulties – though that is of powerful impact as most endowed trusts in the UK have 60% or more of their investments in equities. The full impact of the removal of charities' ability to reclaim Advance Corporation Tax on their dividend income is only now being felt – a real and substantial (and long term) cut in the income of most endowed trusts; and all this at a time of very low interest rates so even the most liquid resources are not earning as much as in the past. Falls, then, in all the traditional sources of income on which trusts and foundations have relied to fund their grant programmes.

The reaction of Trusts and Foundations? Most have been sticking (albeit grimly and somewhat tight lipped) with their current orthodox portfolios, asset allocations and investment strategies. The line being that you never 'cash in' at the bottom of the market – hold your nerve they are told and it will come right. I do wonder if the advisers who say that to the anxious trustees have also sat down with them at any point in the last three years and asked: how much are you prepared to lose? And does the current investment strategy protect you from a worse outcome?

It would hardly be surprising if many trustees are increasingly anxious that they may have not done enough to protect the asset that they hold 'in trust'.

Some UK trusts and foundations have been engaged in a more radical rethink. There does seem to be an emerging scepticism about the orthodox approach to the investment management of endowed charities' assets; even among some of the trustees who are on investment committees and who have usually had a professional career within the very industry that advocates that approach.

I'm not proposing in this session to pursue this issue beyond offering the possibly naïve hope that a radical rethink by trusts and foundations about how they use their assets could extend to include debate about whether some of their resources might be invested in ways that close the gap between the hard boiled men and the Guardian readers.

Throughout the day you have been concentrating on how to maximise financial returns on 'ordinary investments' in as risk-free and prudent manner as possible during volatile and uncertain times. I propose to end the conference by urging trusts and foundations (and other charities with reasonable reserves and assets) to invest some (not much – but some!) of their resources so that they work hard to support the charity's objects while also being 'sweated' to produce a financial return: a double bottom line: financial transactions that are intended both to achieve charitable objects and to deliver financial returns to the charity investor – for a charity, a Programme Related Investment (PRI).

Horse Manure and Grant-Making

I'll start with two references: the first is an article about horse manure – it's an article that was published by the US Council on Foundations during the summer; given the sensitivity of this audience I haven't reproduced the cartoon that illustrated the article. (You can find it in the archive section of Foundation News - the journal of the Council on http://www.foundationnews.org).

The article, *Horse Manure and Grant-making*, was by Jed Emerson: an advisor – formally the Executive Director – of the Roberts Enterprise Development Fund. He's now with the William and Flora Hewlett Foundation - between 1999-2001 he was the Bloomberg Senior Research Fellow in Philanthropy at Harvard Business School.

Jed argued that:

> "We're working with the wrong end of the horse if we focus too much on what comes out of foundations…most of us focus all of our efforts on manure production and mucking activities rather than on whether or not our horses are headed in the right direction!"

As the cartoon illustrated, the scale of the total assets (i.e. the horse) is massively greater than the income generated in any one year (the manure). In the USA foundations are required to distribute 5% of the value of their assets each year – in the UK there is no such requirement and few trusts or foundations will be distributing a sum that is equivalent to more than 3 or 4% of their total assets (and a good many will distribute less).

In his article, Jed points out that:

> *"5 percent* of our resources are driving *100 percent* of our social mission, and *95 percent* of our resources are judged solely on terms of their *financial* performance alone, regardless of whether those investments may actually be destroying the very social or other value we seek to create"

he went on:

> "Fewer than 15 percent of the more than 56,000 foundations in our country make any use of social or other "screens" to guide the investment managers of their assets. An even smaller number of foundations make use of program related investments or other strategies in attempts to leverage the long-term value of their philanthropic capital.
>
> "Only a handful of foundations engage their financial managers in creative discussions with program staff regarding how to *maximize* the foundation's social, environmental and other value-generating efforts.
>
> "By not pursuing a unified investment strategy—one that considers the total performance of both foundation philanthropic and market-rate investments—we leave significant potential impact (and social returns!) on the table.
>
> "By not engaging in total foundation asset management we are consistently missing the point of philanthropy, which is not grantmaking itself, but the application of precious resources to support the creation of a more whole, just and peaceful world.
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> "Our goal should be the integrated use of financial and social tools applied to that purpose, not the use of one set of tools in the absence of the other.
>
> "Despite this fact, many foundations "only" make grants and virtually never bring their larger talent pool of finance and program staff together to discuss how they might collaborate to more effectively work toward the achievement of their shared mission".

Referring back to his manure and the direction that the horse was taking, Jed posed a key question for the "philanthropic farmer":

> "How do we best manage the *total* assets of the foundation to maximise its value as a resource?"

Jed is obviously going well beyond discussing Programme Related Investment (PRI) here – and I don't have time today to make all the connections between his argument and the UK situation. There are lots. The gap in the UK between the objectives of a charity's investment strategy and its reasons for existing are at least as wide as those in the USA to which Jed refers. However, I'm not going to open up the debate at this stage of the conference about whether and how charities invest ethically or with a 'social responsibility' label. I am going to concentrate on PRI – a form of investment that the Charity Commission argues is not an 'ordinary investment'; so it's the subject of separate debate from that about screening of 'ordinary' investments – ethical stock selection, socially responsible investment and so on. PRI has to be managed and accounted for separately from the rest of a trust or foundation's 'ordinary' investment portfolio.

Social Investment Task Force

My second reference is to the outcome of the recommendations of the Social Investment Task Force. A Social Investment is a 'double bottom line' investment for an individual or an institution – aiming to deliver both a social and a financial return. The Task Force was set up to address how such investments could assist the development of enterprises in what we described as 'under-invested communities'. Our report, Enterprising Communities: Wealth Beyond Welfare was published almost 2 years ago to the day – the Task Force continues to meet to monitor and encourage progress on implementation; indeed it met this morning. The report and supporting documents can still be read at www.enterprising-communities.org.uk.

One of the five recommendations that the Task Force made had particular relevance to the charity sector and to this session – three of the others were primarily targeted at government and the finance industry and one at the voluntary sector and organisations involved in the development of community finance. When I was invited to speak to you, I was asked to refer, if only in passing, to the progress made on the implementation of all five recommendations:

1. the tax credit to encourage investment by individuals and institutions in what the Task Force described as "Under-invested Communities" is on its way into implementation;
2. the first Social Venture capital fund is fully financed and has been launched
3. some of the banks – notably Barclays and the Coop have moved substantially on disclosure of lending in the poorest communities;
4. the Community Development Finance Association is up and running and providing support, representation and advocacy for the 'demand' side of the social investment sector.

The fifth recommendation? That argued for:

> "greater latitude and encouragement for charitable trusts and foundations to invest in community development initiatives."

This recommendation was based on our assessment that charities and community organisations had "done important, pioneering work in the area of social and community enterprise." Trusts and foundations, in particular, had been key early funders of social enterprises, community businesses and community led regeneration in some of the country's poorest neighbourhoods - but we concluded that there was "confusion" as to whether it could be charitable:

- to fund community development and to support new commercial enterprises (could it ever be charitable to help an enterprise into existence which, if successful, would generate profit and personal gain)
- to assist employed people when supporting the regeneration of communities (the language of current Charity Commission guidance seeming to indicate that everyone living within a regeneration area must be out of work and penniless)
- to invest some of a charity's assets for a less than maximum financial return within those communities where poverty of income and opportunity was concentrated and inequalities most marked – to make a Social Investment.

The Commission's response was to be encouraging on all three:

They confirmed that it could be a charitable activity to fund community development, to support new commercial enterprises and to assist employed people when helping to regenerate under-invested communities (i.e. to fund not just charities)

And, addressing the confusion about what was permissible that we had encountered, they commented that:

> "Many charities, their trustees in particular, have had it drummed into them that, when you are investing charity money, you have got to get the best possible return. That's where the confusion has arisen".
>
> "Any charity that can give grants can undertake this type of programme related investment unless it is specifically prohibited in the charity's governing document."

The Commission followed this immediately positive response by publishing in May 2001 one of what they rather splendidly call *"Useful Guidelines"* (would you set out, I wonder, to produce some *non-useful guidelines*?). These guidelines are currently being revised and made more comprehensive; in the May 2001 Guidelines, the Commission confirmed that it is OK – and always has been – to invest some of a charity's assets for a less than maximum financial return when to do so will serve the charity's objects and assist current beneficiaries.

"There will be some activities that fall within the charity's objects that can generate some financial return (or where at least the capital is likely to be relatively secure). It is open to the charity to use its income to support these, as a programme related investment …" and
"…in many cases trustees can, if they wish, use some of the charity's endowment to support these projects as a programme related investment…" and
"…the crucial feature is that the charity is spending its money to help its beneficiaries: it is not driven solely by financial return. This means that the normal rules on financial investments do not apply".

PRI and Trusts and Foundations
That then is the background – for most of the rest of my time I'd like to spell out ways in which PRI could be adopted by trusts and foundations. But first, four general points about PRI:

1. the opportunity for charities to use some of their resources to make a social investment – a PRI - is not new, as John Stoker emphasised when introducing the Useful Guidelines: "Essentially we're saying that charities probably have more latitude to make programme-related investments than they might have thought – if indeed they'd thought about it at all. We hadn't thought about it ourselves before the Chancellor's appointment last year of the Social Investment Task Force". It's not new – and it's not rocket science.

2. it's also not just about trusts or foundations with expendable endowments. If you can make a grant you can do PRI – from income if you have no endowment or if the endowment is a permanent one.

3. charity finance is not 'static' – when discussing the financing of a voluntary organisation, there is sometimes a tendency to assume that nothing changes, that a single snap shot will provide an accurate and permanent portrait of the circumstances and needs of the charity. The reality is that organisations do evolve and change:

    a. charities and community organisations ***need*** different types of finance and support at different stages of their development (when new and financially vulnerable, the most unrestricted and uncomplicated funding possible may be critical – anything with obligations or that involves long term commitments could be too much)
    b. charities and community organisations are ***capable of using*** different types of finance and support at different stages of their development (as they grow stronger and more confident, tendering for contracts, taking on tightly restricted project grants – all become more feasible and routine)
    c. charities and community organisations ***can generate*** different types of finance and support at different stages of their development

(income streams becoming substantial enough to finance repayment of some of the working capital used to develop the activity from which the income is flowing; products or intellectual capital that can be sold; fees that can be earned for providing specialist expertise).

PRI is not an appropriate form of funding support for a financially vulnerable charity or if it adds burdens to those that already oppress trustees – but it could be entirely appropriate as one way of resourcing a more mature and robust charity or to support the implementation of a feasible and – eventually – income generating financial plan.

An example to illustrate these points: when I was at HACT in the late 1980's, our balance sheet consisted mostly of loans to voluntary organisations; these were 10 year no interest loans; so laid back we didn't start pushing for repayment until the 9th year and often had to gently remind some of the debtors that they still owed us. These debtors may have been small and struggling voluntary organisations 10 years previously when we lent them £10,000 to help equip or adapt a building. By the end of that period, some had grown to become major housing associations – the Notting Hill Housing Trust or Paddington Churches – easily able to repay; and almost none of those loans were defaulted on – even though at the time they were made, the long term prospects of many of the organisations that HACT helped were far from certain. (And the discussion with some of the big Associations about their loan repayment quickly moved on to me suggesting that they were now big and strong enough to make a donation to HACT!).

4. A final general point about PRI: it is an addition to the funding armoury; it's not necessarily about alternatives to grants – indeed some of the most effective forms of PRI are likely to be those that are made alongside and at the same time as a grant, the funder being able to help more substantially by working out with the fund-seeker ways that a loan and a grant could work together to enable something to be achieved.

Types of PRI

So how can trusts and foundations add PRI to the menu of ways they support the charity sector? Here's a list of possibilities:

- Loans – short or medium term, interest free or low interest – to fund activity or developments that should, if all goes well, generate the means to repay. This could involve not only asset development but also start up finance for a new social care service, the repayments becoming one of the costs recoverable through the contract

- Patient recoverable capital – loans that have very patient terms in that no repayments are due for a long time – perhaps not even fixed when the loan is made but a date being agreed when the possible repayment terms will be discussed

- Underwriting – not even paying the money over but accepting a potential obligation to do so if some aspect of a planned self-funding initiative does not succeed fully

- A PRI Property portfolio – if a charity's objects are to relieve poverty (or indeed are just for general charitable purposes as is the case for most trusts and foundations), a property investment in one of the poorest communities, say Brent, could generate a return and some capital growth – but also contribute to the regeneration of that area: a social return in line with the charity's objects and a financial return, albeit a smaller one than you would probably get from investing in property in Belgravia

- An equity stake in a community business or social enterprise – if an appropriately defined stake for a charitable investor can be worked out, PRI could support the development or growth of an enterprise that aimed to meet some aspect of the investor charity's objects.

PRI – using specialist intermediaries

Trusts and Foundations do not need to make PRI direct – they can use an appropriate intermediary. They may choose to do so for administrative convenience – the administration of most of these PRI options is relatively straightforward, but some (such as the equity stake) are more complicated. Trustees may also decide to use a specialist intermediary to avoid being a direct lender – because they would then have to accept the possibility of calling in the debt if something went wrong; reputationally they might wish to avoid that situation. A specialist intermediary – the new Charity Bank, for example, or Triodos Bank which has recently established a PRI link with the Lankelly Foundation/Chase Charity, or a Community Development Finance Institution (CDFI), such as the Aston Reinvestment Trust (ART), or the Venturesome fund at CAF, or the Ethical Property Company which has recently launched another share issue – can also provide technical advice and support beyond that likely to be within the competence of most trusts or foundations. And PRI through an intermediary is not just a potential opportunity for the larger trusts and foundations: a small family trust in the Midlands, for example, has made PRI investments both in the Charity Bank and ART. May many others follow their example.

PRI – why not already mainstream charity finance?

So why is PRI not already mainstream charity finance? Why haven't trusts and foundations got into it already? And what might stop them – and why? After all, an opportunity to add to their repertoire and to make their funds work harder – to use some of their funds two or more times might be expected to sound pretty tempting to many Trustees. There seem to me to be four main reasons for the reluctance of trusts and foundations to add PRI to the ways they fulfil their charitable purposes:

- Grants are simple – for trusts and foundations to make and to administer; why complicate things? (My response? It could be worth the hassle if the money goes further, could have greater leverage potential and a more lasting impact)
- Grants are simple – for the charities seeking funds; why complicate things and get all involved thinking up new options for financing your work and taking on new obligations to report and repay? (My response? It could be worth it if you can access new or additional funds – and also demonstrate that you are an organisation that is capable of incorporating this sort of 'mature' finance in your planning and operations?)
- The Investment Orthodoxy: the overwhelming majority of charities rely for advice about their investment strategy on their investment managers; it is perhaps not surprising that the orthodox view that the primary duty of trustees is to maximise the financial return on the their assets that they 'hold in trust' has a strong grip
- The assumption that PRI must be risky. This is an intriguing – but very firmly held – view. A grant seems to me to be a higher risk – after all, once it's paid over it's gone! PRI offers the possibility of getting the money back for using again. I recall that when I was trying to persuade a seriously well qualified investment committee to consider setting aside 5% of their (then cash) endowment to support property based PRI health related work in poorly provided for areas, the option was firmly resisted as far too risky; instead the money went into equities including such wonderfully prudent stock selection as Marconi – risky or what!

And trusts and foundations are labelled (and label themselves) as 'grant-making' trusts – even the Directory of Social Change calls them that! That's what they do – it's hardly surprising that that is ALL that they think they can do. Several trusts and foundations are looking positively and with enthusiasm at PRI – some have already made loans and other forms of PRI – but the prevailing culture and the attitudes to which I have just referred are not going to change easily whatever the quality of the case put forward by advocates of PRI and the charities and voluntary organisations that can see ways that they could use PRI to strengthen or to grow their work. The latter – the 'demand' side – have a crucial role in determining if PRI becomes more than a talking point; organisations seeking resources will have to be imaginative and resourceful in making strong and convincing cases to trusts and foundations as to how PRI could be of value to their efforts to improve or extend the services they provide. I think they could in time reap considerable benefits from the investment of time in doing so.

Conclusion

PRI, then, has potential and offers tangible and diverse opportunities for both the providers and users of charity finance to do more with their resources – but it's also a challenge to a number of orthodoxies: those that prevail among investment advisers, operational charities – the fund seekers – and the staff and trustees of trusts and foundations – the fund providers. The challenge may be exacerbated by the volatile times that we are going through – though I hope these may actually create a bit of space for PRI possibilities to be considered. The challenge is straightforward – for trusts and foundations to concentrate grants where they are the only or clearly the most appropriate option and to use other types of funding wherever possible to further their charitable objectives. That way the funds available to the trustees of trusts and foundations go further – to go beyond grants.

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PROGRAMME RELATED INVESTMENT –
Should Charities Invest in the Community as well as in the Market?

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