Summary of the 17th Annual Financial Innovations Roundtable

March 9-10, 2017
Federal Reserve Bank of Richmond, Charlotte NC Branch

Executive Summary

Over the past fifteen years, the Financial Innovations Roundtable (FIR), located at the Carsey School of Public Policy at the University of New Hampshire and hosted by the Division of Consumer and Community Affairs at the Federal Reserve Board of Governors, has worked with a range of community development and other types of financial institutions, government agencies, foundations and trade associations to address and solve problems related to access to capital for low-and moderate-income consumers and communities. The FIR does this by tapping the expertise of thought leaders from the institutional investment, banking, philanthropic, and community development industries.

The 2017 Financial Innovations Roundtable (FIR) focused on "Donor Advised Funds as Investors in US Community Development." The FIR was hosted by the Federal Reserve Bank of Richmond and held at the Charlotte Branch. Historically, Community Development Financial Institutions (CDFIs),[1] and other community development organizations have largely depended on government grants, bank debt driven by the Community Reinvestment Act, and (to a lesser extent) grants and program-related investments from foundations for their capital. Donor advised funds (DAFs) are an increasingly popular charitable giving vehicle in which donors can deposit a sum of money and receive a tax break on that deposit immediately, then make donations from that fund over time. There exists the opportunity for community development organizations both to receive donations from these funds and to seek investments from fund balances that have not yet been deployed to grants.

This year's Roundtable brought together impact investors and community development practitioners to explore the barriers and opportunities to involving donor advised funds as investors in community development. Key takeaways from these discussions include that:

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[1] Community Development Financial Institutions, according to the Opportunity Finance Network, are private financial institutions "dedicated to delivering responsible, affordable lending to help low-income, low-wealth, and other disadvantaged people and communities join the economic mainstream." See the Opportunity Finance Network website at www.ofn.org or the US Department of the Treasury CDFI Fund website at www.cdfifund.gov for more information.

- **DAF sponsors seek impact investing options to present to their clients that are easy to manage and have liquidity to enable grant-making**. Many (although not all) investment options in community development organizations lack features that DAF sponsors want to see, especially liquidity and daily pricing.

- By finding and underwriting impact deals throughout a community, Community Development Financial Institutions – **CDFIs – could present a "solution sell" to DAF sponsors who do not have the time, and may not have the experience, to engage in impact investing at the deal level**.

- **The community development field needs to communicate a crisp and appealing story** to DAF donors about how community impact investing can grow businesses, improve housing, and strengthen families and communities in the United States. It will need to be prepared to **address donor interests around specific issues and geographies**. The terminology of the space (including the term "CDFI") is wonky and convoluted, and needs to be simplified. Currently, there is a limited awareness among DAF donors about impact investing – including community development investing as a type of impact investing.

- Many community development organizations will - and should - collaborate with community foundations on "boutique" investment offerings focusing on a specific community or region. However, **there are opportunities to develop commoditized community impact investment products, such as a community development mutual fund or Exchange Traded Fund (ETF**,) that could be placed on DAF platforms and selected by donors as an investment option. A number of participants strongly recommended that community developers should work to develop these tools, in partnership with existing players in the ETF and mutual funds industry.

- **Research is needed to test how different ways of presenting impact investment choices to donors could impact their decisions**. This research should be informed by recent advances in the field of behavioral economics.

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Framing Remarks

Matt Martin of the **Federal Reserve Bank of Richmond** welcomed participants. He noted two ongoing community development efforts in Charlotte that provide examples of the sorts of initiatives that DAFs could support in conjunction with CDFIs. One is the Charlotte-Mecklenburg Opportunity Task Force, a partnership seeking to improve economic mobility in the region, which is ranked last among large US metro areas for this indicator. The second is CommunityLink, an initiative

to address an affordable housing shortfall in the region that has been estimated at 30,000 units.

Joe Firschein of the **Federal Reserve Board** briefly discussed the importance of community development to the Board, as it relates to their responsibilities for monetary policy, the Community Reinvestment Act, and their bank supervision functions.

Michael Swack of the **University of New Hampshire Carsey Center for Impact Finance** framed the work for the discussion, relating that Carsey has found a number of donor advised funds who have been involved in a wide range of community development investments. This year's FIR builds on last year's conference that looked at the challenges of engaging impact investors in community development. At that 2016 FIR, participants raised the idea of working with DAFs, which now hold in excess of $70 billion in assets under management. Swack laid out an agenda for the conference of first building understanding of how DAFs work and their constraints; then looking at how DAFs are already engaging in community development; then describing for DAFs the range of investment opportunities that exist currently in the field, and finally mapping strategies to facilitate further connections between DAFs and the community development world. Swack highlighted challenges that these strategies must address, including the question of "plumbing" (how community development financial products are bought and sold), marketing and explaining the importance of "community development," and addressing investor desires to impact specific issues in specific geographies.

"Overview" panel discussion of DAFs

- Eileen Heisman, National Philanthropic Trust
- Stefan Podvojsky, Fidelity Charitable
- Holly Welch Stubbing, Foundation for the Carolinas
- David Levitt, Adler & Colvin (via videoconference)
- Catherine Godschalk – Calvert Foundation, moderator

David Levitt of **Adler & Colvin** provided a legal overview of what is a donor advised fund (DAF,) how do they work, and legal constraints on their investment activities. The Pension Protection Act of 2006 codified DAFs by incorporating them into the Internal Revenue Code - prior to it, the Internal Revenue Code did not define what a DAF was even though they had existed in practice as far back as 1931. The Act was motivated by concern about whether DAFs generated questionable types of transactions. Levitt noted that there are not yet any Treasury Department regulations interpreting the DAF provisions of the Act, and there is a good deal left to be interpreted.

A DAF is a fund that is separately identified by the contributions of donors that are owned or controlled by a public charity. The donor expects to have non-binding advisory privileges over the distribution or investment of funds. The sponsoring

organization is the owner of the assets, not the donor. Full tax benefits are available to the donor at the point of donation but the donor irrevocably gives up any legal control over those assets. The sponsoring organization owns the money; the assets are its property and are under its legal control.

The 2006 Act establishes certain excise tax rules:

- First, there is the concept of a taxable distribution, which can trigger an excise tax of as much as 20% on the sponsor, including a 5% tax on the fund manager. As a result of this rule, most distributions go to public charities, but DAFs can make other grants for a charitable purpose if they exercise "expenditure responsibility" over the grants. Most DAFs prefer not to make grants involving expenditure responsibility. Distributions to individuals are prohibited.

- Second, the code limits return benefits to the donor or donor advisors. There is a 125% excise tax if a distribution results in more than an incidental benefit to the donor advisor, or certain family members or related businesses. The tax is levied on the advisor and/or the recipient of the benefit, and the fund manager can also be taxed, in an amount equal to 10% of the benefit, for agreeing to make the distribution knowing that it would confer a more-than-incidental benefit.

- Third, a transaction with an "insider" of a charity can be subject to a tax if there is an excess benefit involved. Donor and donor advisors, as well as certain family members or related businesses, are "disqualified persons" with respect to the DAF, and –any grant, loan, compensation, or "other similar payment" they receive from a DAF is an excess benefit transaction and is taxed. Disqualified persons with respect to the DAF sponsoring organization now also include investment advisors (as well as certain family members and related businesses of the advisor). Whereas donor advisors can't be compensated at all, investment advisors can be compensated but the compensation must be reasonable.

- Fourth, DAFs in general may not hold more than a certain amount of equity in any particular company (typically no more than 20% of any particular enterprise).

A number of these rules come directly from the tax rules governing private foundations. In a general sense, Levitt noted, DAFs are between public charities without DAFs (which have the least restrictions) and private foundations (most restrictions).

Levitt felt that there is a lot left to be interpreted about how the law governs impact investing from DAFs. First, it is possible that some DAF investments could qualify as distributions – similar to the Program Related Investment (PRI) concept for private foundations. Currently there is no parallel tool for DAFs. If an investment is NOT a

DAF distribution, the question then arises, what is it? Likely, the investment would need to meet "prudent investment" requirements that apply to charities for their (non-charitable) investment activity. Such requirements are driven by state law, including the Uniform Prudent Management of Institutional Funds Act that has been adopted by most states.

Moderator **Catherine Godschalk** of the **Calvert Foundation** cited a report from the National Philanthropic Trust that donor advised funds held just shy of $79 billion at the end of last year, across 270,000 different DAFs, sponsored by about 1,000 different DAF sponsors around the country. The industry is growing at more than 10% annually. She concluded that DAFs are "potentially a big opportunity, caveat the restrictions David has mentioned."

Eileen Heisman of the **National Philanthropic Trust,** a DAF sponsor, noted that her organization has about $4.3 billion in assets under management, and has raised $7.5 billion over 20 years. The Trust offers its own DAFs and also private-labels DAFs in partnership with other financial institutions.

The Trust was challenged by its board in 2010 to engage in impact investing, and hired a consulting firm to find impact investing products that are compatible with how DAFs work. Heisman related, "I had maybe 20 meetings with folks seeking investment – most ended with people angry at me. They wanted to have access to our capital, get big chunks of money for the long term the way a pension fund might invest, and they did not take the time or study how DAFs worked. If we are going to bring anything in, it can't be big chunks of money over the long term – that's not the kind of money we have."

Heisman asked her consultants to find "a national program where people could invest small chunks of money for not a long period of time, and that was easy to read about." The Trust now offers four debt impact investing tools now, Calvert Notes being one of them. However, there has been "almost no participation" – Heisman reported that there is about $20 million in impact investment out of all of the Trust's assets under management. Heisman mentioned another impact investing opportunity the Trust built around health issues, only to have no one take advantage of it.

Heisman felt that "there's an opportunity, but I'm not sure how to turn that spigot on." Some dimensions of the opportunity, however, included that:

- Exchange-Traded Funds (ETFs) are "the perfect tool to be transactionally compatible with donor-advised funds. They are small and transactional, they have a value, we can buy and sell them. We have to be able to liquidate to take fees for ourselves." Were the community development field to build a similar tool it might therefore find significant interest from DAFs.

- Heisman felt that “Millennials look at the world differently and things may shift when they become the main investors as opposed to baby boomers.”

- The community development world might be able to better reach donors if it improves its marketing. Heisman commented, “The language of the CDFI world is the most boring, mundane language I’ve ever seen – we need to tell the donors something with emotional appeal. What gets a donor to act? The language in the CDFI world is so dry, obtuse, full of acronyms – to translate for a donor requires some savvy marketing people.”

Stefan Podvojsky of **Fidelity Charitable** noted that Fidelity Charitable has about 20-25% of the DAF market and 90,000 DAFs. Over 25 years it has distributed $25 billion in grants to qualified charities, including some international charities. Podvojsky said, “Our mission is to make grants – while we aren’t legally required to make a 5% distribution each year, we work to encourage and promote grants – last year our donors recommended 840,000 individual grants totaling about $3.5 billion.” Fidelity Charitable is in the early stages of exploring impact investing; Podvojsky noted that “potential for scale and platform development are critical areas of focus.”

Currently, Fidelity Charitable donors have different options for recommending investments for their DAFs. About 2/3 of assets are invested into investment pools that are typically mutual funds or funds of funds. About 1/3 of assets are managed by registered investment advisors (RIAs) and some other advisors, where the guidelines allow for more options and provide “a little more investment flexibility.” Podvojsky noted that “Liquidity is important when we review investments given our commitment to grant-making. When we analyze the aggregate portfolio, we seek to have both diversification and liquidity.”

Holly Welch Stubbing from the **Foundation for the Carolinas** noted that the Foundation has $2.1 billion in assets, with DAFs comprising about half the assets. FFTC is the 8th largest community foundation in the U.S. They have seen high growth in DAFs recently. The payout rate ranges from 20% to 30%. The foundation has given $80.5 million to “community development-esque stuff, but we don’t use that taxonomy,” she noted. “We use an IRS taxonomy – ‘public affairs, human services, affordable housing,’ etc.”

Godschalk asked about product fit: “This is a room of product developers. Could a laddered, CD kind of portfolio work? Can you do scale – can it be a large scale investment with a liquidity investment built into it?”

Heisman responded, “Even if you build it, I can’t guarantee that my donors would participate in it. We’re like an intermediary that then has to talk to donors. I can’t take my development people who are selling DAFs to sell your impact investment project instead – the opportunity cost is huge to deploy them to that. We have 5,300 donors. Even if you put something together I don’t know how much capital we could raise.”

Godschalk commented, "so it is truly 5,300 individual decision makers" [and not one decision maker that a community developer would approach if seeking to raise investments from DAFs via the Trust].

Heisman further clarified, "when we put investment options in front of donors, if there are a few boxes they can check off, we don't sit side by side with them to suggest they choose one or the other. We present pre-approved pools and a la carte options that the smaller donors can do; the larger donors can suggest other pieces."

Godschalk concluded, "So it's not just about creating a product that fits, it also is about how to translate and sell it."

Podvojsky agreed: "You need to have a really good story. We've got 90,000 DAFs and the majority of donors interact with us primarily through our website. We have to provide them with crisp and compelling messages about the different investment and grant recommendation options available to them. For a subset of our larger donors, we provide higher-touch services and, in those cases, have the ability to spend more time discovering their interests and personalizing communications about our programs."

Podvojsky suggested that "community development" and "impact investing" could be seen as one and the same. He recommended that community developers should "put a good story on the web and attract eyeballs. I love Eileen's idea about ETFs – that mark to market on an ETF, that liquidity is beautiful.

Heisman agreed on the utility of ETFs for DAFs: "it is a perfect tool."

Godschalk agreed: "I am a firm believer that Community Development Finance IS impact investing – it is the same thing."

Podvojsky noted that Fidelity Charitable is frequently presented different impact investment products that could benefit from a better story to appeal to donors."

Welch Stubbing commented, "It doesn't matter whether I make a grant or an investment, what I need to do is educate nonprofits about accessing the tools in the toolbox the financial community has."

Heisman challenged participants to improve their narrative and to provide a product that is easier for DAFs to invest in. "The CDFI language is uncompelling – but there's a million interesting stories to tell about the end users. It could be moving video about the impact these dollars might have. There are shiny objects in the sector that people want to buy. But I can't afford to deploy someone just to sell this. Our private label partners are really interested in impact investing inside of DAFs. So the big issues are with storytelling, and with liquidity and regular valuations. We need to work on an assembly line. ETFs are on the market, and you can have pricing."

Michael Swack pointed out that some CDFIs have a lot of individual investors, and asked whether it would make sense for them to become DAF sponsors?

David Levitt responded that "if your CDFI is a 501c3 charity, it is eligible to be a sponsoring organization." However he pointed out practical considerations such as administering the accounts and working with the donors.

Elyse Cherry of **Boston Community Capital** asked about the average amount in a DAF. **Heisman** responded that at the National Philanthropic Trust the average is about $700,000. **Podvojsky** indicated that at Fidelity Charitable the average is about $190,000. **Welch Stubbing** indicated that the average at the Foundation for the Carolinas is about $230,000. All noted that there is a wide distribution around the average.

Cherry noted that Boston Community Capital raised some money for its foreclosure relief fund from DAFs, but felt that "we are not benefitted by having a ton of tiny, individual donors – it's just way too hard. Even if we asked [the National Philanthropic Trust] to private label it for us it would still be complicated. So which is the cart and which is the horse – the intermediaries (sponsors) or the donors? We have good relationships – but getting the folks who administer the funds to tell our story is really difficult – we had to tell our own story." Cherry concluded that "for the CDFI industry, leaving aside the marketing piece for a moment, the critical task is to reach the donors – the donors need to demand it and they will push the sponsoring organizations to figure out a way to get it done."

Heisman commented that if a CDFI were going to run a DAF, "the donor would need to be able to grant to other nonprofits. Why do that when they could just grant you the money directly?"

Godschalk noted that Calvert Foundation is also a DAF sponsor (in addition to being a CDFI). She reported that Calvert has will sponsor a DAF "exclusively when there is an intention on the part of the donor to have the DAF assets support the Calvert Foundation while they are here and to credit enhance as a top loss function a particular aspect of our portfolio."

Cherry asks about whether a CDFI would trigger self-dealing rules if it sponsored DAFs that benefited the CDFI, but **Levitt** said that the key question is whether and how the donor advisor is benefitting [not the sponsor].

Alicia Philipp of the **Community Foundation for Greater Atlanta** highlighted a challenge with the idea of community developers marketing to donors and getting them to go to the sponsor: "The problem is, we can't do 1,000 one-offs. We don't have the staff expertise or the ability to look at each one of those deals and see if it meets our fiduciary criteria. To me the answer lies in creating an Atlanta Impact Fund and allowing donors to take a percentage of their assets and put it into that fund. And then WE decide what the deals are. It is our money ultimately and we need that control but it allows that option."

Heisman commented, "that's a great idea – but hard for us to do that as a national organization." Heisman reiterated that she saw a "really ripe opportunity" with millennials, "but I just don't think the translation is happening."

Bob Schall at **Self Help Ventures Fund–** asked Fidelity about getting an investment from the mutual fund pools in which DAF assets are invested: "Could your mutual funds or financial advisors allow us to be one of the investments in those pools"?

Podvojsky replied that "I get presented investment products a lot by managers trying to get an allocation of pool assets. I don't think I have ever been pitched a CDFI by anyone. DAFs don't have that concept of PRI as David pointed out so all investments in the pools have to go through the same investment due diligence and board approval." **Godschalk** asked, at what scale is that worthwhile to do?" **Podvojsky** answered: "It depends on how we deploy such an investment option and to which audience we target." **Godschalk** followed up to ask about the parameters for what that investment can look like, including whether it would have to have liquidity. **Podvojsky** replied that "it depends which program the DAF is participating in. For pools, the investments are liquid registered products. For DAFs that are managed by RIAs and depending on the size of the DAF, there is more flexibility in terms of the type of investment products we allow. For example, we do invest in private investments that have longer time horizons. These positions represent a very small percentage of our portfolio."

Heisman interjected that "we only lock if a large donor brings us something, but in our pools we have nothing that has lockups." She asked Schall what the shortest term of investment was that Self Help could offer. **Schall** replied that "many of our investments are invested for 1 day" (referring to money market products).

A commenter from Houston mentioned a "Look Book" containing 300 different community organizations, with testimonials, that donors could look at. Ninety percent of the stories received a grant or investment after the "Look Book" was published.

David Berg at the **Underdog Foundation** commented that from a donor perspective, donors should want their highest risk, highest impact, earliest stage companies in their DAF. He continued, "I have not heard any hard core legal issues, and even the liquidity issue is kind of a stealth issue really - private equity doesn't have liquidity. Are there hard legal issues? We have to solve for marketing and build appetite but how much [of the barrier] is a legal issue?"

Levitt responded that "the key legal issue is proper stewardship of a charitable asset. If you have PRI possibilities you don't have to worry about the prudent standards. But we don't have that with DAFs. If that money for which you took a deduction is now gone and not granted out, the question is, would a state attorney general turn around and tell you that you were not prudent?"

Berg noted that Underdog Foundation put into its 501c3 application that assets would be utilized 100% for community development as a way of addressing this issue.

Panel Discussion on experiences of DAF investors and community developers who have worked together

- Michael Wilson, NH Charitable Foundation
- Robert Killins, The Greater Cincinnati Foundation (via videoconference)
- Catherine Burnett, Phillips Foundation
- Kathy Pope, Chicago Community Trust
- Napoleon Wallace -Kresge Foundation
- Moderator – Michael Swack

Michael Wilson of the **New Hampshire Charitable Foundation** described the foundation's experience with impact investing, which goes back to 1971. The foundation began investing in the New Hampshire Community Loan Fund, a CDFI, in the 1990s. The foundation holds about $650 million in assets, 40 percent of which are in DAFs. The foundation has a socially responsible investment pool that has grown to $5 million by the end of 2016, driven by interest from millennials.

The foundation launched an "impact investment fund" at the beginning of 2016. Donors may choose to move all or a portion of their DAF balances into this fund. The board has also agreed to allocate up to 2 percent of the foundation's main portfolio into the fund as well. The fund employs a bulls-eye to evaluate investments for risk adjusted return, social / environmental impacts, and geographic focus. The foundation initially approached a small base of donors, of whom half chose to move capital into this impact investment fund. New Hampshire Community Loan Fund continues to be an investee of the impact investment fund; Wilson described it as "an interesting fixed income investment with a lot of the impact we are seeking locally." He also cited the intermediary role of the CDFIs as advantageous for the foundation, as the foundation likes "to work through partners rather than invest directly in deals."

Robert Killins of the **Greater Cincinnati Foundation** stated that the foundation's first impact investment was a loan to a CDFI in 2001, to do local housing in the downtown area of Cincinnati. Killins felt that the deal helped to catalyze subsequent growth in the downtown housing stock. The foundation now has a $10 million impact investing pool, equaling 10 percent of its unrestricted endowment of $100 million. More than half of its impact investments have been in community development – such as investments in affordable housing and CDFIs.

The foundation has a $540 million balance sheet, much of which is in DAFs. Starting in 2011 the foundation opened up its impact investing pool to DAF participants. In focus groups, donors overwhelmingly said they wanted to participate on a deal by

deal basis. Killins described this strategy as "time intensive… and it can be a bit expensive."

The foundation's underwriting requirements for impact investments "start with a strong social return," according to Killins – "if we can't get a strong social return we will not do a deal simply to help an organization get a better rate or build its balance sheet." The foundation also retains a registered investment advisor, who "helps us to be objective and protect us from ourselves." About a third of investments are in equity, such as venture capital funds as well in seed and pre-seed stage funds that help to catalyze high tech business startups. Killins concluded, "Our program is small but it is across the spectrum."

Michael Swack highlighted the two different approaches for DAF engagement used by the first to presenters: a pool approach at the New Hampshire Charitable Foundation, versus a more time intensive deal by deal approach at the Greater Cincinnati Foundation.

Catherine Burnett of the **Phillips Foundation**, a family foundation based in Greensboro, described the perspectives of the donor (family) she works with. The family office includes a DAF at a community foundation selected for its "robust SRI investment options."

The Phillips Foundation is a relatively new family foundation – it was endowed in 2014 – and is one of only a handful of foundations in the U.S. under Millennial leadership. The Phillips family's company is also managed by their Millennial family members and Burnett noted that increasingly Millennials will hold significant wealth as between $30-$50T in assets will be transferred to Millennials within the next 50 years. Burnett reported that the Phillips family, like many Millennials, is "primarily driven by impact" and does agree with the common foundation practice of disregarding the Trustees' values when making investment decisions. "It doesn't make sense to use one set of values to guide philanthropic giving and then abandon those values when making investment decisions." Burnett suggested that community foundations and other institutions with DAFs must position themselves to meet the growing demand by Millennials of wealth for access to values-aligned investment opportunities.

The foundation's first impact investment was a $500,000 loan to a social business of women making jewelry in Uganda. Although the investment required significant foundation staff time to develop the capacity of the investee to properly service the debt, it also resulted in a 100% increase in the number of women employed by 100%, helped secure a lucrative contract with a major retailer in the U.S., and "ultimately they paid back the investment early."

Based on this successful impact investing experience, the trustees set a goal of having 100% of the foundation's assets driving beneficial impact, which the foundation has largely achieved (it is at 96 percent). Burnett noted that with small, low-return direct impact investments, "we found that it was too time intensive for

our small staff to vet the many opportunities, so we began to use intermediaries and that is where CDFIs come in. CDFIs allow us to have direct community impact in geographic areas and thematic areas of interest to our Trustees, and we rely on the CDFIs to provide the due diligence, technical support, and oversight necessary for our investments to be successful."

Burnett described one barrier to scaling community impact investing as the relative unfamiliarity of CDFIs among donors. She noted that a direct investment in a business empowering Ugandan women to enter the cash economy and achieve financial sustainability is more understandable to most donors than an investment in a CDFI. "The compelling impact stories of CDFIs need to be better communicated to donors," she recommended. "Donors want to know what impact their investment is making – for example, 'this loan fund is helping a low-income mother build a credit history for the first time' or 'this is helping a day care facility to expand to serve 40 more children living in poverty.' Philanthropic investors are inspired by compelling stories of the social return on investment."

Kathy Pope of the **Chicago Community Trust**: described Benefit Chicago, an impact investment offering developed through a collaboration between Chicago Community Trust, MacArthur Foundation, and Calvert Foundation. Benefit Chicago is a $100 million fund focused on the 7-county region around Chicago. The Calvert Notes program provides an easy platform for donors to invest. The Trust brings both its knowledge of community needs and its relationships with donors to the table. The Fund opened for investment in July 2016.

Pope reported that in February 2016, the Trust talked to 50 donors to understand if would they be interested in participating. "The overwhelming response was 'maybe, probably.'" Benefit Chicago is now about a month away from announcing its first loans to the community and the Trust "has been making lots of calls to our donors to remind them of what we talked to them about. And we had a consultant that went out. Frankly, some of donors did not even remember talking to the consultant. That was a shock."

Pope highlighted the need to educate donors about impact investing, citing donors who believe that it simply means investing in ESG-screened stocks. Pope also discussed a challenge in which donors appear slow to embrace using DAF funds for impact investing because they have mentally categorized those funds as "money to give away," even though they do not have a spend-down date for their DAF. Some donors with significant funds have decided to place a direct investment to Calvert as opposed to using their DAF, even when they have DAF dollars that are in the fund. "We are going to have to peel that onion" to understand what drives these donor decisions, Pope remarked. "Is it our conversations with them? Is it their advisors?"

Pope later clarified that DAF money invested in Benefit Chicago will not be available to grant while invested, which "contributes to a lot of this toe dipping, where people just start by saying they will invest for one year."

Pope also noted that "We have seen tremendous growth in dollars going through DAFs. When I first came on board, we distributed about 60 percent of our money from our own endowment and 40 percent came from DAFs. In 2015, 79 percent of the money going out came from DAFs and the total dollars have been growing faster in DAFs than in our own funds."

Mary Vasys later related a marketing difficulty encountered during the research for Benefit Chicago: "The dilemma [for donors] was 'where do I put this in my asset allocation strategy?' Once we called it a fixed income debt security they understood it more, but is it an alternative investment or a fixed income security or a money market?"

Napoleon Wallace of the **Kresge Foundation**: described a deal in which Kresge supported the California Community Foundation to engage DAF donors in impact investing. The California Community Foundation wanted to support a fund being raised by the Corporation for Supportive Housing for homeless housing in Los Angeles. It wanted to raise investments from its DAF donors for this fund, but needed time to work on underwriting, operating, marketing, and other "piping" issues, as Wallace put it, to make that happen. Kresge helped by making a $6 million loan to the California Community Foundation, which was then invested in the Corporation for Supportive Housing's fund. Over the next 6 years, the California Community Foundation will repay Kresge with DAF holders' money. The California Community Foundation is thus syndicating out Kresge's loan. In addition to providing a longer runway for California Community Foundation to build it efforts to engage DAFs, the Kresge loan also leverages Kresge's underwriting expertise, helping to address any legal issues around prudent management of fund, and its brand, helping to convince DAF donors of the worthiness of the deal.

Michael Swack commented how these presentations show a number of ways in which DAF money is beginning to be used, even if there is not yet lots of money flowing.

Debbie Miller of the **New Hampshire Community Loan Fund** asked **Kathy Pope** about the results of donor education briefings. **Pope** responded that the Trust has done briefings for 6 years, generally 3-4 per year. Pope commented that the process has "forced us to do better data mining to make sure people with certain interests are aware of our briefings." **Becky Regan** of the **Housing Partnership Network** asked what motivated the investors to come. Pope responded that she has seen the audience grow over the 6 years they have been doing briefings, stating that "now our donors know the format, and know that we will pull the best and brightest minds in the area to talk about a particular opportunity."

Saurabh Narain of the **National Community Investment Fund** asked whether there was some scope for foundations to fund community developers to "learn how to tell the story" and develop a better language or taxonomy to educate people about CDFIs.

Michael Swack asked about whether there is an opportunity for DAF donors making community development impact investments to also donate to the same entities. He commented that with CDFI fund potentially being zeroed out, there will be a need for capital to grow the sector. He suggested that CDFIs should seek to make a case for donations as well as investments.

Michael Wilson responded that the New Hampshire Charitable Foundation is focusing on particular geographies and issue areas, "so it is tough for us to translate 'CDFIs' [per se] into a story but there is a great opportunity" for CDFIs to connect around those geographies and issue areas.

Evening Comments
Mark Mullinix presented the history of Community Development in the Federal Reserve System, highlighting the fact that the Community Reinvestment Act of 1977 (CRA) set up a process to enable citizens and community groups to protest a bank's practices and individuals were needed to help navigate the formal administrative process of filing a protest. He went on to discuss how the function has evolved to that of a partnership with financial institutions looking for community investment opportunities, and a partnership with community groups looking for funding, and now the Community Development role has shifted toward facilitating that process of helping relationship build to address economic challenges in low- and moderate-income communities. Mark thanked the attendees for their service to communities and the country, and told the leaders he looks forward to hearing about the impacts and challenges going forward.

Framing Remarks for Day Two

Michael Swack summarized challenges from the first day's discussion including legal issues, marketing, and investment liquidity. Counterbalancing those challenges are the many examples already in place of DAFs placing investments in community development.

Swack highlighted findings from the field of behavioral economics, that "how you set up or frame a decision for someone influences what they end up doing." He gave an example of how TIAA-CREF provides a simple "check the box" way for retirement plan participants to allocate a portion of their portfolio to ESG-screened stocks. Behavioral economists have also found that structuring a choice as an "opt out" (the default is that a percentage DAF funds are invested in impact funds but the donor can check a box to opt out) results in higher participation compared to presenting an identical choice structured as an "opt in." Swack suggested that research is needed to present different messages and test different choice framing in an experimental context, to understand the impacts on donor decision making.

More broadly, Swack suggested that there is a need to create options "where it's easier for people to invest." Investors may not know about the options, may not be encouraged to present the options. From what David Levitt told us most CDFIs would not have a problem meeting the standards required to invest DAF money in community investments.

Capital Users Panel

- Ellis Carr, Capital Impact Partners
- Bob Schall, Self Help
- Kerwin Tesdell, Community Development Venture Capital Alliance
- Calvin Holmes, Chicago Community Loan Fund
- Frank Altman, CRF, moderator

This panel described a range of community development impact investment opportunities that are currently available.

Bob Schall of **Self-Help** described two credit unions that are part of the Self-Help family. Investment options include liquid money market accounts, as well as Certificates of Deposit and interest-only notes for 1 to 5 year terms. Deposits are insured up to a balance of $250,000. Rates are in the market range of other insured deposits. Schall commented that "sometimes investors want a higher yield," and that people sometimes have trouble comparing yields among alternatives on a risk-adjusted basis. Self Help has rolled out a CD that has a CUSIP number, enabling it to be traded electronically, with 2- and 3-year terms.

Schall noted that Self Help also has a nonprofit loan fund. Overall, Self Help's capital needs "range from 1 day to 20 years or anywhere in between." The challenge for Self Help in marketing its more liquid opportunities is that its specific needs for liquidity change from day to day. Schall concluded that it sounded like a daily-to-3-year range is the most likely possibility from DAFs.

Kerwin Tesdell of the **Community Development Venture Capital Alliance** described venture capital investing opportunities. Community development venture capital funds make equity investments in businesses in low income areas, with the social goal of creating good jobs that are accessible to lower-income people and building entrepreneurial capacity in low income communities. Some funds are nonprofit, but most of the larger funds are traditionally structured VC funds. Typically these funds are 10 year limited partnerships; capital is called from investors into the fund, then invested in equity investments in businesses, then liquidated. Investments are illiquid- as Tesdell put it, "we will get your cash back to you whenever we have it, might be 3-4 years, 7-8 years or 10+ years even though they are 10 year LPs. And it is high risk. We can't guarantee return of principal." Tesdell is interested in reaching individual investors, including smaller investors.

Ellis Carr of **Capital Impact Partners** described his organization as a national, S&P rated CDFI with a mission to "provide equity and opportunity to communities, and to ensure that all communities that we work in have access to high quality services." Capital Impact has invested $2 billion in underserved communities nationwide in education, health care, food and housing. The typical loan size is between $1.5 to $3 million, but could go as high as $12 million. Examples include financing to establish a grocery in a food desert; help to a health care center expand, or provide dental or mental health services to an at risk population. Carr emphasized that "finding new sources of capital is very important to us." Capital Impact has spent the last two

years developing a notes offering to leverage its AA S&P rating to encourage investors to invest in community development projects. Key tasks in that process have included "Solving for transparency and providing a DTC-traded product that is rated, that offers different terms for different investors, and that can leverage our S&P rating."

Calvin Holmes of the **Chicago Community Loan Fund** called his organization a "hyper-local fund" that has leveraged over $1 billion of public and private financing in Metro Chicago, in pursuit of a vision that "every community in Chicago will achieve its fullest potential." The Fund invests in four primary asset classes – housing, community facilities, retail and office, and social enterprise. About three quarters of its loans are short-term, pre-development loans, such as a loan the Fund recently made in a major retail development in a low income community that will employ 200 local residents, including ex-offenders, and provide contracts to 30 micro-businesses and small businesses in the community. The Fund seeks three types of investments:

- Unsecured, illiquid, senior loans that pay investors returns of 1 to 2 percent over terms of 2 to 5 years.
- Subordinate investments at a slightly higher rate of return. These lenders are still protected by a 30 percent net assets position in the fund, but would take the first loss beyond that. These funds are placed for a 5 year term which rolls over to a total term of 10 to 15 years. Holmes described these loans, which are known as "EQ2" loans, as "essential on the ground in communities," in part because of the difficulty neighborhood institutions have had getting bank investments after the recession.
- Grants, which provide a loan loss reserve to "take risk in the market place," and which fund research and development. For example, the Fund piloted a "neighborhood investment program" to help small, local landlords to buy and fix up small rental properties with loan amounts that can exceed the value of the property, preventing these properties from becoming drug houses and helping the families of these small landlords to build wealth.

Holmes felt that the Benefit Chicago initiative (described previously) is helping to attract long-term capital from investors "who otherwise do not have the time to understand us." Holmes also suggested that national community development finance associations such as Opportunity Finance Network and the National Community Investment Fund could help to "connect the two sides" with their intermediation and asset management functions.

Frank Altman of **CRF**, a national nonprofit loan fund, described CRF's mission to "help people improve their communities through innovative finance." CRF primarily helps groups that finance small businesses that create jobs in low-income communities or are owned by disadvantaged borrowers such as women, minorities and veterans. CRF purchases loans from these groups and issues asset-backed securities, which are now rated by Standard and Poors. The securities are DTC-registered and have CUSIP numbers – they are tradeable but not liquid.

Altman asked participants to "put the Venn diagrams together" to see where are the intersections between the kinds of capital we are trying to raise and what DAFs have. Altman described a collaboration in which CRF worked with the Calvert Foundation to attract DAF money to an "Invest in Minneapolis Fund" the Calvert Foundation set up through its notes program. DAF donors at the Minneapolis Foundation can place money in the Fund, which is then lent to CRF.

Calvin Holmes discussed how the Benefit Chicago platform is helping to connect impact investors and community developers through its asset-liability management capabilities. Holmes described how a local institution is looking at making a large, 1- or 2-year investment in Benefit Chicago, who would then relend the money to the Chicago Community Loan Fund for a longer term. The investor could decide to roll over their investment, but Benefit Chicago has more tools in place than the Loan Fund to manage the refinancing process and risks.

Allison Clark of **MacArthur Foundation** provided more details about Benefit Chicago. MacArthur has invested $50 million of the $100 MM fund at a term of 15 years. The Chicago Community Trust has invested another $15 million at a term of 10 years. The remaining $35 MM is being raised through the sale of Calvert Notes with different tenures. **Kathy Pope** added that Calvert reports that on average, investors stay in Calvert Notes for 10 years even if they do a 1-year term on their investment. Benefit Chicago is seeing interest in 1-year notes as a start, although one donor has committed a significant investment for the full 15-year term.

Ellis Carr stated, "We recognize that DAFs could play a role as a portion of the capital in our space, and are open to shorter term vehicles to entice this community into investing in Capital Impact." **Calvin Holmes** added that "if we can leverage the investment opportunity to raise the brand of community development more generally, that would be helpful."

Elyse Cherry raised the issue that "we are just coming out of a period of low interest rates into a period of volatility and increasing rates. As people think about rollover rates, I'm thinking a lot about how that will impact people's willingness to invest and the terms for which they will invest."

Holmes responded that "one of the other features that Benefit Chicago is trying to bring forward is addressing the variable interest rate environment. Investors could agree to a rate for the first couple of years but then get a higher rate even though the investee gets a fixed rate."

Mary Vasys of **Vasys Consulting**, who worked on Benefit Chicago, answered that "we thought a lot about" the issues Cherry raised, and that the MacArthur money helps to mitigate liquidity risk. Vasys continued, "the other aspect behind the scenes is that MacArthur is also guaranteeing the loan to Calvert – investors buy a Calvert note and MacArthur guarantees it – so investors are protected at multiple levels." Vasys acknowledged that "As interest rates rise our cost of funds will go up; we've

lent at fixed rate and our margins are potentially going to be squeezed, but MacArthur was potentially willing to absorb that through its placement of equity."

Bob Schall commented that "the two sources of friction are liquidity and pricing the interest rate. For rate, we need to find a common framework for a comparable risk-adjusted interest rate for these types of investments. This is hardest to do for nonprofit loan funds. The S&P play is one way of trying to establish a benchmark of products with similar terms and ratings. On the liquidity side, while most investors might keep their money in for a long time, most investment managers want to be able to exit at any time they want to, so that they can manage their portfolio. That has been difficult for CDFIs to manage. That's one reason we created a DTC-registered product, since a DTC product can be sold in the marketplace." Schall emphasized the importance of making progress to resolve these issues.

On the issue of liquidity, **Becky Regan** felt that "the mistake we make is that we talk about needing long term capital. We will never win that battle. We need to take term off the table and look at liquidity – let people get in and out."

Ellis Carr felt that Capital Impact "can somewhat absorb interest rate shock" in part because of its high level of productivity in short-term construction loans. Carr continued, "As rates rise in the traditional space, we don't pass all of the interest rate increase along to our borrowers. We are not profit-maximizing and expect some compression in the spread."

Beth Marcus of **LISC** asked to "better understand from the DAF side what are the needs for interest rate in particular." Marcus also shared a thought based on Michael Swack's framing comments about behavioral economics, noting that "in Chicago we saw the individuals being more comfortable with grant making than investing," even though such behavior does not conform to the rational-actor model of traditional economics.

Stefan Podvojsky responded that "The fixed income products that CDFIs are offering could resonate with donors and may fit into the overall allocation of the portfolio, offering diversification. DAFs tend to be more balanced. Donors use DAFs as a vehicle to get more money to charities and are uncomfortable with the possibility of diminishing the value of their donation – so their risk profile is conservative. This may advantage fixed income products."

Frank Altman raised the issue of addressing donor interests in particular "impact verticals" and geographies. Altman felt this issue presents both a challenge and maybe an opportunity for community developers: "how do we slice and dice the work that we do into products and services that meet the requirements of donors interested in a specific vertical and / or geography?" Altman emphasized that if this and other issues can be resolved, with investment of only 1 percent of the $70+ billion in assets under management at DAFs, "the community development finance industry would be going for another 20 years."

Calvin Holmes responded to Altman that "If you care about Chicago there are very few issues or impact verticals that our work doesn't support."

Kerwin Tesdell responded that "we are starting a Puerto Rico fund - that is very much a place based way of thinking. But on the other hand, the impact investing world tends to think a lot in terms of product as opposed to place. A lot of money behind new impact investing is people who want to apply their way of thinking they learned in business to other societal problems – not at all a location based way of thinking."

Ellis Car felt that Capital Impact has had to " navigate between themes and geographies. For example larger banks may have a geographic interest, foundations may have a thematic interest. We've had several examples of creating funds with both a geographic and thematic focus – for example, around housing in Detroit."

Kerwin Tesdell added to Altman's question: "there's the location vertical, the impact or product vertical, and then there's the financial product question… I worry that Venture Capital is difficult. What happens when we've got this mass market money coming in where the person at Fidelity who is selling this really just wants to be able to check the box?"

Stefan Podvojsky responded that Fidelity Charitable does invest in private investments like venture capital funds and hedge funds, "probably 3 to 7 percent of our portfolio." Podvojsky added, "For larger DAFs, we are comfortable investing some portion of the assets in products with longer holding periods. Many factors are analyzed when making this determination and the entire portfolio must be reviewed to ensure there is adequate liquidity notwithstanding the longer holding period of a minority of the assets."

Frank Altman pushed participants to consider the creation of an Exchange Traded Fund: "The idea that came up yesterday [from DAF sponsors] is – if we had an ETF that would be perfect, anyone can invest in that. I want to throw that out as an idea to try to move things forward. How can we use this forum for innovation to investigate whether we can create an ETF or series of ETFs that are tradeable, that focus on different issues areas like environment or gender or education?"

Michael Swack commented that "probably the biggest obstacle" to creating an ETF "is what MacArthur has done, which is creating a liquidity reserve. But the operational aspects are not that difficult for firms like Fidelity or Pax World who set up funds all the time for specialized purposes. You have to meet the SEC requirements and understand the potential market for it. I think it is potentially a really good idea."

Reggie Stanley of **ImpactUS** answered that the "stepping stones" to make an ETF viable are "getting a product registered and creating a tradeable basket – which is underwritten by a series of folks. Then there are the distribution issues. It can all be done. I do hope that ImpactUS marketplace will allow for some of the packaging

that could help trading in a more familiar way and eventually lead to a registered product. As a group we have to continue to work at moving along that path."

Michael Swack noted that available data suggests that the industry overall has had strong performance, and that a number of CDFIs have now obtained good S&P ratings. He asked, "Is this the way the field needs to be moving in order to create these mechanisms?"

Reggie Stanley responded that "this industry doesn't lack in track record – recognizing it through known sources like S&P is helpful, and the Aeris rating system is helpful. There are still many ways you could package a product even without those ratings."

Eileen Heisman pointed out that this discussion "is applicable not just to DAFs but to the larger marketplace. ETFs are one of the fastest-growing investment tools. Our world is so transactional, we need valuations. When things are hard to value, you take them off the assembly line and it is much harder." Heisman referred to Swack's comment that TIAA-CREF retirement plan participants can simply check a box to allocate money to socially responsible investing. She commented, "You don't have to be totally immersed to make a simple choice… it's a different kind of marketplace, if we could put something that is easy to put on and understand. The lack of liquidity creates a huge barrier to entry - and [the ETF] solution would open up investment from outside of DAFs."

Heisman asked about a program that Schwab Charitable launched in which DAF donors helped to guarantee microfinance loans made by the Grameen Bank. **Altman** asked if other DAFs have used guarantees, and whether some sort of a combined guarantee fund could be put together. **Stefan Podvojsky** commented that the concept of a guarantee can be challenging to explain to donors. He commented that Fidelity Charitable does have capabilities for recoverable grant-making, which allows for lending-like agreements between donors and non-profits.

Stefan Podvojsky commented broadly on the opportunities for connections between DAFs and community development – "people are looking for more place-based and values-based investing options" – and the opportunity to apply the lessons of behavioral economics with online tools – "designing these offerings with the donor/user experience design is a key."

Tesdell asked DAF sponsors about two different mindsets that DAF donors might have. On the one hand, if the donor emphasizes certainty of getting the money out to charity, s/he would want to be very safe. On the end of the spectrum, donors "might have the psychology, 'I've already given this money away' and the major way I will do good with this money might be through investment of higher risk money to communities.'" **Elyse Cherry** responded that she was thinking about the tax position of the various donors. "If I put $1 million into a DAF and had taken a

deduction, then you say, 'put that money at risk,' I'd rather not do that through the DAF. Part of the challenge is thinking through how the donors think about it."

Gerardo Espinoza of **LEAF Fund** asked how a community impact ETF could stand out amongst the thousands of ETFs that already exist – "How difficult would it be to get people's attention?"

Greg Ratliff referred to the success of Kiva and highlighted the marketing challenge: "We have to get the personal story in front of the donors in a way that resonates. If you can figure that out, then it might be worth investing in an ETF, but you have to invest in the story piece first."

Alicia Philipp observed that "DAF holders at community foundations are very different from DAF holders at national charities. Community Foundations are high touch and we charge more. People choose us if they want to go deep. For DAF holders at Community Foundations, place matters – 70 percent of our grants stay in the metro Atlanta area. With community foundation DAFs – we go and talk to donors individually; it is not a mass marketing effort but the end result could be significant engagement." **Altman** responded that Philipp had "just made the case about why CDFIs should try to get to this difficult market."

Becky Regan echoed Philipp's comments. "You can't look at the DAF market as a bucket- we need to match our needs to investor interests. For example, we started Develop Detroit in Detroit – there is a bucket of investors who left Detroit, the "expats" who want to support Detroit. Are they putting their money in the Community Foundation there? How do we match with those donors?"

Problem Solving Panel #1 - Exploring Commoditized Approaches

- Walter Sweet, Rockefeller Philanthropy Advisors
- Dana Bezerra Pancrazi, FB Heron Foundation
- Moderator–Jeremy Nowak – former President, William Penn Foundation and founding CEO of The Reinvestment Fund

Jeremy Nowak opened the session by suggesting that the product discussion in the previous panel fell into two broad categories:

1) The set of bespoke transactions, some of which became larger patterns like Chicago benefit fund and its structured finance, a bit more than boutique. These transactions are very focused around place and around knowing the donor. The transaction costs might be high but there exists a great deal of affective connection and possibilities moving forward.

2) A second category where finance is more of a commodity, such as ETFs or mutual funds, where the commodity may have as a part of it the ability to solve some

community investment problems, but it is a commodity with a certain level of anonymity to it. The nature of markets is really around anonymity.

Nowak opined that community development finance has been remarkably good at "identifying where can you convert the boutique to the commodity; then you can find another set of boutique things that you can do." He placed this capability in the context of a problem: "not just the potential cuts to the CDFI Fund, but the weakening of Community Reinvestment Act enforcement and many of the other programs of civil society that we care about."

Nowak related that when he ran The Reinvestment Fund 10-15 years ago, Vanguard approached them about created a fixed income mutual fund, labeled as "high impact bonds," that would include paper from CDFIs, Housing Finance Authorities, and infrastructure investment. Vanguard offered run models to figure out liquidity, and asked The Reinvestment Fund to advise on allocation strategies for the CDFI notes. Nowak never went forward with the idea, but pointed out in his remarks that " there were people within the mutual fund industry who felt there was a way to do it- and it had to fit within their commodity structure." Nowak continued, "Frankly, pricing isn't that big of a deal. Whether it is an ETF or a Mutual Fund with CDFI and other paper in it, there has got to be a way for CDFI paper to be bought and sold in the market now. Markets are too efficient and too smart. This is not to say there isn't a really important role for the boutique and the bespoke. Also, we are not the only ones who balances boutique and commodity investments– Goldman Sachs does that as well."

Dana Bezerra of **Heron Foundation** discussed how Heron has collapsed its grantmaking and investment functions to flow through the same team. The underwriting screens are the same: "what's the impact, how knowable is it; then we switch to underwriting the economics of the deal; then we look at what type of money can make the deal work; then we look at whether the dollar is a charitable dollar." Bezerra clarified that while Heron is 100 percent invested for "impact," "the bad news is when you set out to do that you learn how far you are from being invested for mission."

Bezerra related research that found a "massive difference" between community based foundation DAF advisors and other DAF advisors. She recommended, "We have to stop fighting about which is 'right' and just meet people where they are… let's create a bigger middle ground including ETFs and public debt products," not just the more "artisanal" investment opportunities.

Walter Sweet of **Rockefeller Philanthropy Advisors** works with with high net worth foundations, corporations, and other donors to advise them around their plans for giving, "educate donors about the ways they can make a difference," and help to manage their grant programs. Sweet suggested that "we need to reconcile the philanthropic impulse with the market based investing approach… we always try to approach it as 'this is another tool that you can use to make impact.' The ETF

model could get us out of the boutique space where I tend to play. I think that is really promising."

On marketing Sweet agreed with the idea that "you have to do away with using words like 'CDFI.' We work with successful business people – you need to speak with them in language they can understand." Sweet also touched on the potential to better harness technology, for example to help investors understand exactly where their money is invested, and whether it is going to communities and causes they care about. Sweet felt that "there is an opportunity for some entrepreneurs and for philanthropy to seed some of the groundwork, certainly among millennials."

Nowak asked, "What's the constraint to creating an ETF or a mutual fund that we could develop with Fidelity or Schwab or Vanguard that would have CDFI paper in it - particularly given the sophistication of CDFIs now, some of which have S&P ratings?"

Bezerra replied that "there really isn't a constraint." Bezerra described how Heron issues specific its investment managers to pursue impact, for example by investing only in Mortgage Backed Securities containing fixed-rate and not adjustable-rate mortgages. She reports that managers "just said 'okay'," and "we didn't have to send them to re-education camp" to do that.

Nowak stated that the amount of demand now searching for private debt and private equity offerings that have impact is "really significant." He continued, "the question is, do we have the product? I was giving a primer to a family experienced in impact investing, but they weren't familiar with CDFIs as a product. That is a marketing issue that can be overcome. So: let's workshop the idea of creating a commodity."

Sweet agreed that "we are seeing more folks becoming interested in this. There's been a complaint for a long time about the product and the issues we've talked about. But it does feel like things are starting to change."

Nowak praised ImpactUS for its work to create "a platform for a product and do it in a way that has great simplicity… when we get to a plug and play platform, we get somewhere really significant."

Elyse Cherry suggested that "in addition to focusing on donors, we could do more by focusing on advisors - like Bar Associations, estate planning folks, accounting firms." She noted that these advisors may try to dissuade clients from impact investing if they are not familiar with it. **Sweet** agreed: "I speak to Bar associations and others about this issue – there is a large group of folks who are still skeptical about [impact investing] and feel it is their responsibility to object. " But he also stated, "Maybe if we do more of what is being talked about here the advisors will follow."

Eric Hangen of the **Carsey Center for Impact Finance** asked whether Bar associations and other advisors would be more amenable to an impact investing

opportunity that had a more conventional "look and feel," such as a mutual fund. **Nowak** felt that this would be the case.

Cherry related that Boston Community Capital also looked into establishing a mutual fund at one point. "The two hurdles we could not get by were daily pricing and liquidity. No matter how much I said 'it's the same loans, the same interest rate,' it didn't sway people."

Nowak suggested that with a portfolio mix, liquidity issues can be dealt with. He praised MacArthur for how it has used its balance sheet to support initiatives like Benefit Chicago and suggested that in the current difficult environment, the industry such strategies to be brought to scale. He suggested that "the boutique [community investments] will help to create the commodity – that is what MacArthur has been doing successfully," showing proof of concept for how good liquidity and credit enhancement could support a scaled investment product.

Kerwin Tesdell inquired about progress that Calvert Investments had made using the portfolio mixing strategies that Nowak had mentioned. **Reggie Stanley** affirmed that Calvert Investments had included "special equities" as a small part of the portfolio. **Frank Altman** added that at Calvert there was a limited portion of assets that the Fund could hold in nonpriced, nonliquid instruments, but that identifying that across all mutual funds "is probably a huge number."

Bezerra added, referring to the marketing of a commodity tool such as an ETF or mutual fund, "we need a simple way to opt in - we don't need boxes of tissues and tears."

Nowak urged participants to look at what www.neighborly.com is doing right now with Municipal Bonds, providing a simple internet portal to facilitate investment into this space. Nowak recommended that "What CDFIs need in my view is a group that is thinking about product development and technology that is not trying to run past the suitability issue for CDFIs. We need R&D resources because the opportunity and the social sentiment are there."

Frank Altman addressed the issue of daily pricing, noting that the Lutheran Church pension fund, which is regulated by ERISA, wanted to invest in a fund to help predatory lending victims to stay in their homes. With help from Fannie Mae, the Church was able to establish a daily price for their investment. Altman concluded, "It's hard to do but you can do it," and that creating daily pricing "would open up a huge chunk of the institutional market that we don't have right now." **Nowak** agreed that the key is to have a consistent methodology and apply a reasonable set of rules; "that transparency of rulemaking then gets you a fact."

David Berg of the **Underdog Foundation** suggested that the Canadian market could have lessons for how to resolve the market pricing issue, in that retail investors are able to participate in venture funds through their individual retirement funds, and receive daily pricing on those investments.

Eileen Stenerson of Wells Fargo observed that "Cracking the code" to get community impact investing on an exchange-traded basis would "open up a lot of avenues for the retail investor," including employees of large companies that have committed to Corporate Social Responsibility but currently have very limited options for impact in their 401(k) plans. **Nowak** concurred: "this opens up the possibility for customer demand to succeed. If we have product for this customer, everything changes."

Bezerra also agreed and mentioned Union pension plans as another large investor category that could open up, such as SEIU and 1199. Bezerra explained that concerns around fiduciary duty are misplaced. "At the end of the day you have duty of care, duty of loyalty - don't create profit for yourself - and duty of obedience to mission, which is in state level case law. Unions are appreciating that they might want to invest in things that are consistent with their mission – that's not something they should have to fight to do. At Heron, we have come full circle on the question of fiduciary responsibility and believe you have an affirmative obligation to know what you own and how it affects your mission."

Sweet asked, "Only a handful of foundations have done what Heron has done. Why is that? " **Bezerra** discussed two factors: one, that "we've set ourselves up that conventional investing is the gold standard" when it comes to investing; and two, that philanthropies "are rewarded for being painfully artisanal" on the impact side.

E. Julia Shin of **Enterprise Community Partners**: felt that the idea of an ETF or Mutual fund providing an industry exposure was "fantastic," and suggested that an S&P rated note would be a simple way to get started. She suggested that liquidity did not necessarily need to be provided on a daily basis but perhaps less frequently Shin pointed out that some criteria are needed by which to select the membership of that instrument, and perhaps an investment advisor to underwrite the organizations. She asked the panelists, "As you sit in your underwriting roles at this point, would you accept a product that asks you invest at the industry level?" **Bezerra** and **Nowak** both replied "absolutely, we do that already."

Michael Swack noted that **Joe Keefe** of Pax World and **Debra Schwartz** of MacArthur have been interested in this idea of a community impact mutual fund. He noted as well that "through Calvert, we have a delivery channel." Swack agreed with Shin that liquidity could be less frequent than daily and could perhaps be addressed by liquidity enhancement. As to the mechanics, Swack said, "I know there is brain damage but people have done this stuff… the operational aspects of this are very well known by a lot of people."

Nowak suggested that Carsey and others could convene a small group of people to do the exercise of developing a product, in collaboration with a mutual fund company. "We are poised to take that step. And it isn't just a CDFI product – it is CDFI paper within a product, that's really important." **Bezerra** highlighted the importance of partnering with organizations that have existing capacities in that process.

Calvin Holmes asked whether there was any possibility that Treasury Secretary Mnuchin might be able to help this effort, as a part of the President's commitment to move the needle for rural and inner city America. **Michael Swack** asked whether this is the time to revive the idea of tax exemption on earnings for certified CDFIs. **Jeff Merkowitz** of the **CDFI Fund** indicated that the CDFI Fund has gotten some general indications of support from the Secretary, but that "these are things to get in front of the Secretary."

Problem Solving Panel #2 – Concluding Observations

Panelists:

- David Berge, Underdog Foundation
- Reggie Stanley, ImpactUS
- Lori Chatman, Enterprise Community Loan Fund
- Andy Rachlin, TRF
- Allison Clark, MacArthur Foundation (moderator)

Allison Clark of MacArthur Foundation communicated the Foundation's excitement about its partnership with Benefit Chicago. Clark noted that one of the challenges they have had is to explain the importance of intermediaries in community development to donors.

Lori Chatman of **Enterprise Community Partners**, has been looking at alternative sources of capital to support the community development field – "not just CDFIs but community developers who also need capital." Chatman said, "Our look at DAFs is an outgrowth of the Great Recession – when that came about we realized it would be important to diversify sources of capital; we were very dependent on banks, government-sponsored enterprises (GSEs) and government."

Enterprise created a note that looks like the Calvert note, and has raised $60 million in investment thru that note so far. It worked with the National Philanthropic Trust to put the note on their platform but did not receive much uptake through that vehicle. Enterprise has generated more uptake recently with a place-based strategy, and with a series of "salon dinners to tell our story to donor advisors."

Enterprise is looking at impact investing strategically. It has launched an initiative entitled "Accelerating Impact Investing," that looks at what infrastructure and marketing is needed to attract retail investors to community investing. According to Chatman, this research has included work with cultural anthropologists "to help us understand what we are actually communicating. They did man on the street interviews to show us what people think about when they hear 'affordable housing.' The language as we speak it does not resonate in any way shape or form." Chatman promised to turn over their learnings to the broader community development community.

Andy Rachlin of **Reinvestment Fund** shared that he was optimistic about the possibilities to engage DAFs. He commented that "Certainly we must work on language, but when people find out what we do it is wildly sexy. I got a phone call from a company managing family office money. They asked about our note program and wanted to put it on their platform. They did not ask about rate or liquidity - they had read the prospectus. That's not the normal conversation but it was striking that this call got made, which would not have happened a few years ago – they were looking to differentiate themselves." At another conference, Rachlin found that "for a lot of people impact investing meant high risk, high return investments in impact-driven companies – while most CDFIs are better at debt. It was mind blowing for people that debt investments could be impactful."

Rachlin recommended that a community impact mutual fund should include more than just CDFI paper. He also noted that when he goes to impact investing conferences he says that TRF is an "impact debt fund" not a "CDFI." Rachlin felt that Collaboration with other parts of the impact investing industry could help to create diversified product that works on larger capital platforms – "If we can start to integrate across those kinds of boundaries there are interesting opportunities."

Reggie Stanley of **ImpactUS Marketplace** described how his organization is creating an impact platform that aggregates product of various sorts - including CDFIs as well as private debt and equity. The platform has a user interface allowing investors to sort and filter based on geography or impact theme, as well as to research a company and the issues they serve and the metrics they use. Since ImpactUS is are a broker-dealer, the platform will then allow investors or their advisors to trade, with ImpactUS providing the back office administration. Our administrator is Gemini Hedge Fund services, which provides "all kinds of reporting and distribution capabilities." That platform is expected to go live in April.

Stanley related several key takeaways he had from this year's FIR:

- "Language matters, but that what we do is amazing. It is 'painfully artisan' but also more needed than ever."
- "We've got to go at this concurrently from multiple points: products, distribution, standard setting, reporting, capital raising, marketing. It's really clear how important it is to not think of one solution or one way of pushing change."
- "The next meeting we have, everyone needs to bring a millennial and three tech people with them. The world is changing in so many ways that requires the linkage between generations and enabling tools."
- "We don't know where things will go with policy and tax changes. For a while we got a little bit comfortable with relying on the sources of capital that were there. Now we have to access the broader impact space – including individuals, institutions, and philanthropic organizations."

David Berge of the **Underdog Foundation** described a number of ways his organization works with DAFs, such as:

- Their first ever venture fund was privately funded through DAF investment. Berge described the process of obtaining this investment as donor-driven, in which the donor motivated the sponsor to handle impact investing by tying their willingness to invest to the sponsor's willingness to handle the investment.
- Underdog has provided advice to a donor who donated his company, 70 percent to a community foundation and 30 percent to a local community development bank. This donor then asked the community foundation to do a guarantee with the value of their stake in the company. Berge described this process as a "reverse layup" for getting DAF sponsors involved.
- Underdog has underwritten and invested some of its corpus in private equity deals, had some of its own donors invest in them, and then opened up the opportunity for donors at other community foundations, which otherwise have too small a team and not enough unrestricted assets to invest.

Berge discussed unmet demand among high net worth customers for true impact investing options. He related one call he received from a Silicon Valley entrepreneur who had formed a DAF but felt that the sponsor "won't let me do anything – they've got nothing for us [for impact investing]." He related another story where a group of wealth advisors admitted that all of them had lost large clients recently because "what they had on the platform was the same as everyone else." Berge concluded that "solving for give years forward, we will have robo-advisors, millennials who can move their own stock, and people who will want to make fast and fun selections and do interesting things. Community development people have some great stories to share, so I think these are great opportunities."

Allison Clark asked if the prevalence of CRA compliance money in the community development space has distorted how we think. **Chatman** responded yes - "and the cost of capital from that is so low that it has not forced us to solve the problem of how to be attractive to others."

Clark asked, "how do you describe the value proposition? What are we selling to a high net worth individual? What are the lessons CDFIs can learn from how community foundations approach their investors and vice versa?" She noted that in both cases we have intermediaries arguing that they can add value (both CDFIs and Community Foundations serve intermediary functions).

Chatman added, "How do we talk about the work that we do in the language that community foundations have already started conditioning their donors to understand?"

Reggie Stanley identified investment advisors as a key stakeholder for our business; therefore we should learn the language of an advisor and what motivates them. Stanley stated that ImpactUS is "trying to put together something that truly streamlines [advisors'] business. They hate to spend a lot of time on something they feel is a rare client that comes in the door. They want to see something in their language, sort and filter on the things their client says are important to them. And

get their distributions right and their reporting right for their clients, if there is an interest check coming, a capital call coming – that's central to their job."

Berge indicated that "most foundations we work with are either thematic or regional so they need differentiators. Last week I spoke with a foundation and the CEO said one of their biggest pressures was to 'shift from dead to living donors' – in particular to attract and serve more younger donors. She was excited about community development impact organizations' ability to leverage a bigger story. Community development groups are still small enough that we can customize – give some one a $20 million opportunity in a specific city for example."

Berge highlighted DAF sponsors' interest in liquidity – "to me that means we're talking about cash. There has been less conversation than I thought there would be about community development banks. Cash solutions are always a good baby step."

Michael Swack raised the theme of collaboration: "People in the field think they collaborate really well, but if you ask about effective collaboration qualities you see that it is actually really difficult. If we are going to effectively reach the DAF money whether it is an ETF solution or a Mutual Fund, it will require more collaboration than what the field is used to." Swack asked Chatman to talk to how to facilitate this work. **Chatman** responded that we need to "find the trusted convener where they can facilitate our moving beyond the basics of just 'meeting together' and allow for something real to come out of it. People may need to give up something – for example, maybe one group should do all the servicing for others. We could become a lot more efficient at doing our day to day business." **Jeremy Nowak** agreed, pointing out that while at Reinvestment Fund, "I was busy running an organization and didn't have the time to take up this gift horse Vanguard was offering."

Rachlin wondered whether a need exists for new organizations to play certain roles, for example as market makers collecting assets from multiple CDFIs. **Chatman** highlighted ImpactUs is an example, commenting, "It can't be created by one and then not supported by everyone." **Swack** questioned whether a new organization was needed given that we have groups like HPN, CRF, and ImpactUS.

Becky Regan of HPN described her organization as "a collection of deployers of capital" that is working on a $250 million impact investing vehicle to deliver enterprise capital to 20 members. "For us," she said, "creating one platform to collect capital to be delivered down to our organizations is the perfect version of that collaboration."

Frank Altman pushed back on the idea of collaboration and recommended that participants frame their thinking instead in terms of value chains and value networks. "Collaboration is something you are forced to do because some good might come from it but where is the value? We can't get to scale unless we find ways of adding value to each of our organizations." Altman noted that "we all create our own products but we think that we have to do it a 'special' way. If we want to bring those products to an ETF there will be a lot of friction. How do we start to

think as an industry that wants to have massive impact? That's been the biggest challenge. It's really through value added exchanges that we will build the industry." Altman cited the example of PolicyMap, development by Reinvestment Fund. "For 2 years I saw no value – but now we see the value and buy it, and it helps us dramatically reduce our costs of determining impact." CRF will be launching a network with 7 business lending CDFIs that are going to find ways to get high impact loans delivered through an online system. "We have all agreed that we will come together to offer one standard product. If we can add value we will see this whole industry going in a different way."

Mary Vasys asked about standardization of impact reporting. **Swack** referred participants to the 2013 FIR that was held on "Measuring CDFI Impact and Performance."