

Foundation investment: Integrating money and mission

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Philanthropic foundations typically seek to deliver public good from private wealth over the long term, with many pursuing an investment strategy aimed at perpetuity and tailoring their grants programme to match.

While some foundations developed ethical policies to bring investment activities in line with their mission, overall the historical norm has been to view charitable grant making and the investment of foundation assets as almost entirely distinct. However, the recent growth of social investment – with an estimated value of over £200 million – is now encouraging foundation trustees to consider merging money generation and social impact, and a new statutory power to engage in social investment exemplifies the UK's public policy in this area (see [Philanthropy Impact, Issue 10 Part 1, p48](#)).

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Keen (or curious) foundation trustees do not have an easy path to tread, however. Though guidance has been issued by the Charity Commission and institutions such as Big Society Capital, trustees considering social investment can be forgiven for confusion around terminology and mechanics. And one cannot fully fault trustee cynicism about the discrepancy between the amount of discussion of social investment and its actual practice.

This article takes a high level look at social investment by charitable foundations, highlighting

the legal and practical considerations for trustees and senior foundation managers to consider.

Some social investment basics

There is no universally agreed definition for 'social investment'. In the UK context, the phrase usually describes any investment that generates both a social and a financial return, but it is sometimes used to refer more narrowly to 'programme-related investment' where financial return is decidedly secondary. In this article, the term is used to refer to the provision of repayable finance which achieves some degree of both a social impact and financial return.

Social investment most commonly consists of the provision of loan finance to a charity or social enterprise, which in turn repays the loan over an agreed term, sometimes with interest. Equity investment is possible where a foundation wishes to subscribe to shares in a social enterprise, for example. In addition, 'quasi-equity' is often used to refer to scenarios where a foundation investor is entitled to receive a portion of revenues. Quasi-equity arrangements are typically used where traditional equity is not possible because, for example, the investee is formed as a company limited by guarantee and cannot issue shares.

Social investment's framework

As a means to generate money and deliver a beneficial mission, social investment occupies the space between grant making and pure financial investment, ranging quite widely. It is worth recapping the different requirements and matters for trustees to consider when contemplating grant making or financial investment:

- **Grants** can only be made by trustees in furtherance of a foundation's charitable objects. Trustees will be focused on issues such as whether the intended application falls within the foundation's charitable purposes, and considering imposing appropriate terms on the grant to ensure proper application to the agreed purposes. Achieving a significant



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impact which furthers the foundation’s objects will be at the forefront of the trustees’ mind.

- In contrast, **financial investment** can only be made by trustees in accordance with their legal powers and duties, including as set out in the foundation’s governing document (which typically requires advice to be taken if needed and diversification to be considered), and the trustees’ general duties (to preserve the foundation’s assets, and act with due care and prudence; overall to act in the foundation’s best interests). Trustees will be focused on the bargain to be made: the reliability of the intended investment, the attributable risks, the potential for financial return, and – generally speaking – in maximising the invested assets as prudently and safely as possible. Achieving a strong and secure

financial return for the foundation will be the overriding objective for the trustees.

With the above in mind, one can start to appreciate the broad ambit of social investment. Breaking the category down into its three main subcategories – programme-related investment (PRI), mixed motive investment and financial investment with a social impact – can help to clarify it.

Programme-related investment

As the above table illustrates, programme-related investment (PRI) sits immediately beside grant making, and is centred on delivering a foundation’s mission. PRI involves the trustees making an investment that:

- Can be justified on the basis that it is *wholly* in advancement of the foundation’s charitable objects
- Is for public rather than private benefit

Figure 1: SocialPioneers’ Transformation Evaluation Framework™ (STEF)

Application of funds	Requirements	Return	Public benefit requirements?	Falls within objects	Investment requirements/ duties?
Financial investment	Must be made in accordance with the powers set out in the foundation’s governing document and the trustees’ duties	Solely financial return	No	No	Yes
Financial investment which achieves a social impact	Must be made in accordance with the powers set out in the foundation’s governing document and the trustees’ duties. There’s a social impact, but the risk profile justifies the investment	Financial return first and foremost, but with some degree of social return as well	No	No	Yes
Mixed motive investment	Must be for the achievement of a social impact and for a financial return (despite not being justifiable as PRI or financial investment)	Both a financial and social return	Yes	No	No, but needs holistic consideration, careful planning and detailed measurement of social and financial return
Programme Related Investment (PRI)	Must be in line with objects of the foundation	A social return, and some degree (or at least the possibility) of financial return	Yes	Yes	No
Grant making	Must be in line with objects of the foundation	Solely social return	Yes	Yes	No

- Generates, or at the very least has a possibility of generating, a financial return.

PRI, much like a grant, cannot be made if it would fall outside the foundation's purposes. Therefore, the key question for foundation trustees is whether they would be able to make a grant as an alternative to the proposed investment. If not, the investment cannot qualify as PRI, and would need to be justified either as a financial investment or as a mixed motive investment in order to proceed.

In considering PRI, trustees should weigh up if the investment would be the best way of advancing the foundation's aims. Particularly, they should investigate and understand the likely financial return, and in view of that ensure that foundation funds are applied appropriately (i.e. not excessively invested into a risky venture, with much riding on financial return).

If trustees decide to undertake PRI, there is no requirement that they must seek the maximum risk-adjusted financial return, as would be the case were they to consider making a financial investment. Trustees can therefore engage in PRI despite higher risks and/or lower financial returns than other investments available in the market.

Trustees should, however, undertake careful measurement of the social impact of their PRI. They will want to ensure that the foundation's objects are being furthered effectively by the PRI (especially if the attributable financial return is negligible), so as to ascertain whether the PRI is a justifiable means of advancing the foundation's mission.

The various competing 'impact measurement' methodologies are outside the scope of this article, but foundation trustees must grapple with the issue of measuring social return in respect of grants as well as PRI.

Financial investment with a social impact

This type of social investment overlaps with financial investment, and – apart from the fact a social impact is also achieved – is otherwise identical in nature to financial investment; it is primarily focussed at generating money for the foundation which can then be used to further its purposes.

Such investment does not fall within a foundation's objects, but rather is justified wholly on the basis of risk-adjusted financial return. While the trustees may give preference to an investment which would generate a desirable social impact over one that would not, the

bottom line must be the viability of the investment. If it cannot be justified as the best financial return available within the level of risk the trustees consider appropriate (in accordance with the investment provisions in the governing document, the investment policy and the trustees' general duties of care, prudence and acting in the foundation's best interest), then it cannot be justified as financial investment.

In making a financial investment with a social impact, trustees will need to monitor the financial health of the investment. Should they conclude that financial return to the foundation has not been nearly as advantageous as it could have been with alternative options in the market, it will be difficult to justify continuing with the investment, unless it could perhaps be justified as mixed motive investment.

Mixed motive investment

Mixed motive investment is the most complex form of social investment from a legal perspective, being not only hard to define, but sitting as it does the greatest distance away from grant making and financial investment.

A mixed motive investment is essentially one which provides:

- A social impact (although one not falling within the foundation's objects)
- A financial return (although one which is not quite viable enough on its own to justify the investment).

In other words, it is an investment which cannot qualify as PRI or financial investment, because it would not further the foundation's purposes or offer the best risk-adjusted financial return.

Helpfully, the Charity Commission does recognise in its guidance that trustees are able to receive a discounted financial return on investment. Furthermore, the acceptance of greater risks or lower expected returns in exchange for bigger social impact is becoming increasingly common for charities. Nonetheless, the stakes are high with regard to mixed motive investment, and include criticism and/or accusations of trustees having failed to adhere to their duties, or even having mismanaged charitable funds.

Having established what it is not (i.e. PRI or financial investment), the challenge is then to establish exactly what a planned investment is. The trustees should view the investment holistically, in order to evaluate its merits – this is best achieved by a detailed examination

of the proposed investment from all angles, weighing up its risks and benefits.

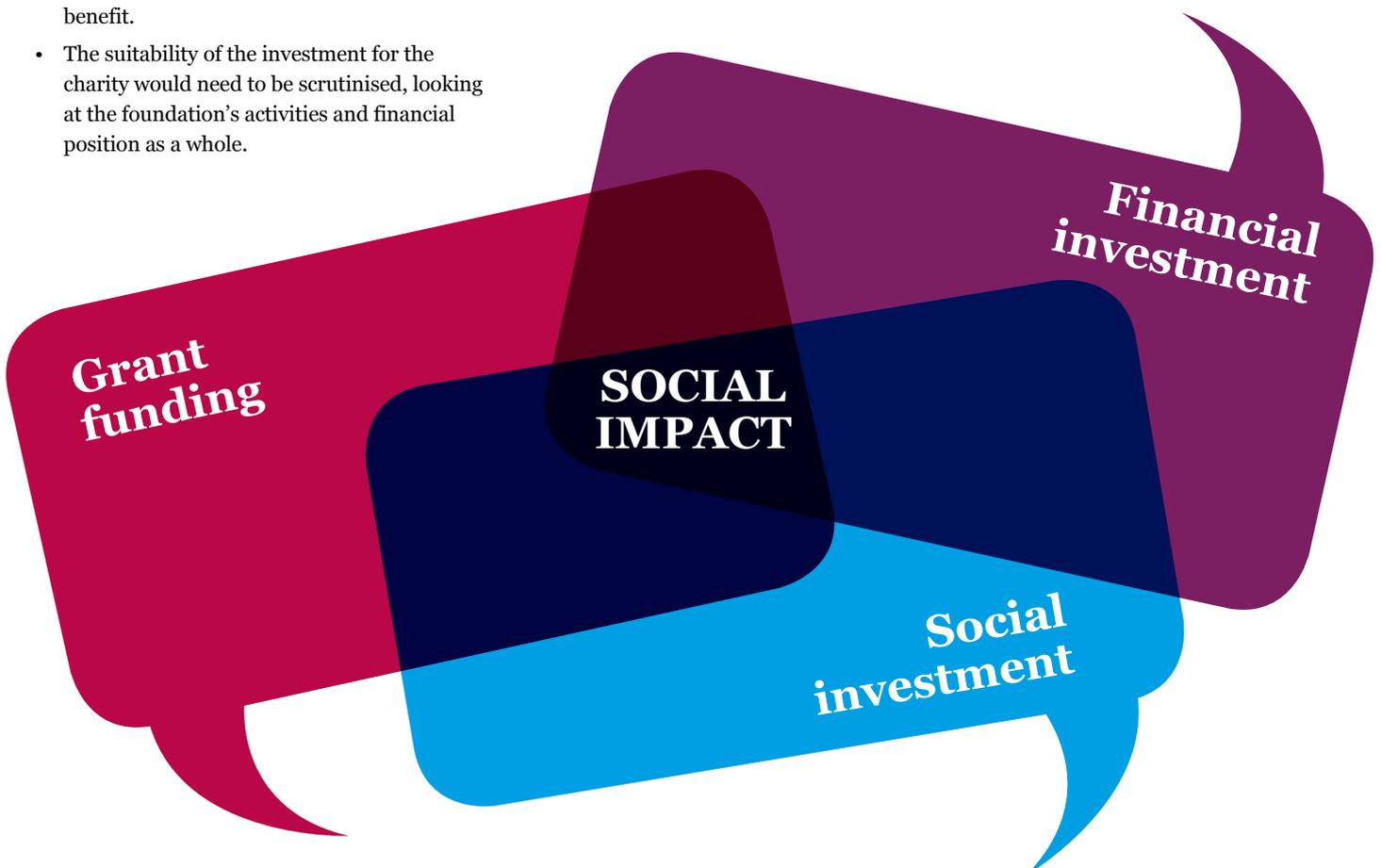
- The trustees will want to identify the social impact of the investment, and estimate its extent as accurately as possible. The more clearly the trustees can quantify what the probable social impact would be, the more able they will be to weigh it against the reduction in financial return.
- The social impact will be easier to justify as a counter-balance to reduced financial return if it relates to the foundation's objects. If the social impact bears no relation to the foundation's purposes, the case for the investment being in the interest of the charity is weaker than if a correlation could be made between impact and purposes.
- The trustees will need to ensure that no inappropriate private benefit would be generated by the proposed investment, and – like PRI – that the investment is for public benefit.
- The suitability of the investment for the charity would need to be scrutinised, looking at the foundation's activities and financial position as a whole.

- Above all, the trustees would need to be sure that undertaking the investment would be in the best interest of the foundation.

Having decided to make a mixed motive investment and recorded the reasoning for doing so, measuring the investment's impact – both financial and social – will be very important for the trustees. If an investment is failing to deliver on either of its dual objectives, it would be difficult for the trustees to justify continuing it as a mixed motive investment. Trustees will want to consider and refer to Charity Commission guidance on approving the investment and should consider taking advice as needed.

And so....

The growth in social investment in the UK has led to the development of a permissive regime, one that presents viable alternatives to the traditional dichotomy of grant making or financial investment. However, this is still a developing area, and mixed motive investment



in particular presents a challenge for trustees – in classifying, determining and justifying – as well as a risk should insufficient analysis or thought be engaged in to render decisions defensible.

Foundation trustees are, of course, not bound to consider social investment but those ignoring its development are surely closing off an avenue for delivering public good. Social investment can, and does, sit alongside traditional grant making and can in some circumstances enhance a foundation's ability to achieve its mission.

Trustees must grapple with some new terminology and should keep the considerations described above at the forefront of their minds. However, if trustees' analysis is appropriately thorough, justification for a particular type of social investment is carefully recorded, and money generation and mission achievement measured and reviewed regularly, trustees can have little to fear, and much to gain, from steering their foundation towards this new and fast expanding domain.

Alana Petraske advises families, businesses, institutions, and the charities they establish on a range of issues including tax-efficient giving, structuring of charitable and non-profit entities, venture philanthropy and social investment. She has a particular interest in family involvement and succession issues in family philanthropies, as well as the interplay with family business, and a deep experience advising universities and other institutions on their international operations.

Alana also focuses on international issues facing both donors and charities, including governance for global charitable groups, cross-border operations and gifts, local recognition of foreign organisations, and the establishment of US/UK 'dual qualified' charities which enable tax-efficient giving in the US and the UK.

In addition, Alana advises giving intermediaries, including donor-advised funds, community foundations, 'friends of organisations and Study Abroad programmes. She has experience advising on a wide variety of operational matters including: grant making, fundraising, sponsorship and trading, constitutional reorganisations, campaigning and elections, tax, governance, FATCA and Common Reporting Standard classification, and regulatory matters generally.

Alana is ranked in Chambers and Partners for charity law and for charity law and education in Legal 500, where she is noted for her 'passionate expertise'. Alana is also ranked in Citywealth and Superlawyers for charity law.

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