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Impact Investing for Small, Place-Based Fiduciaries: The Research Study Initiated by the United Way of the Bay Area

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December 2012
Working Paper 2012-05
http://frbsf.org/cdinvestments

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Please note: The Investment Committee of the United Way of the Bay Area researched and developed the following process for constructing a model portfolio that would align with its mission to reduce poverty while also complying with traditional fiduciary standards. The United Way of the Bay Area was the initial seed ground for this study. It will follow developments in this new field with interest. UWBA has not endorsed and does not sponsor any particular investment strategy at this time.

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Executive Summary

Most fiduciaries of institutional funds (public-defined benefit plans, endowment funds, and quasi-private/public foundations) for many reasons have been reluctant to adopt Impact Investing, Social Responsible Investing (SRI), or Environmental, Social and Governance (ESG) factors in their investment policies and philosophies. Primarily, such social impact factors are deemed to be limiting to the opportunity set of investments and therefore imply a financial return that is potentially substandard. As fiduciary duty interpretations have evolved over the years, current practices seem to dictate a sole focus on achieving a maximum rate of (risk-adjusted) return without regard to the social or environmental externalities in the world today. Resource scarcity, such as energy or water, or other limits to growth, and the consequences of climate change are in our future but are not incorporated into standard Modern Portfolio Theory and Capital Asset Pricing Models, which base risk model factors (correlations) on historical asset class relationships. Nonetheless, current practices of fiduciary standards today would consider creating portfolios that would incorporate ESG factors or positive social-impact intentions in addition to prudent financial returns *only* if they can be shown to be "economically indistinguishable" from traditional investment opportunities as measured against traditional, standard, backward-looking benchmarks.

This paper is the result of a challenge to identify if and how a model portfolio could be built for a small, place-based endowment fund, like that of the United Way of the Bay Area (UWBA), and whether our stock and bond investments could be aligned with the mission to reduce poverty in the San Francisco Bay Area without deviating from our fiduciary responsibilities. The Investment Committee undertook the challenge to create a process that (1) would identify appropriate investments, (2) build a model portfolio, and (3) test that portfolio against current financial theory, traditional metrics of risk and return expectations, and traditional diversification standards, and (4) seek alignment with the long-term goals and objectives of the organization while also (5) meeting our fiduciary duty as defined by UPMIFA (Uniform Prudent Management of Institutional Funds Act) and Prudent Investing standards. We also recognize that a small portfolio of stocks and bonds has a limited, indirect impact on poverty at best. It is our hope that the potential public conversation about building a prudent portfolio under current fiduciary standards that is aligned with a specific place-based mission could have a much larger impact on influencing the flow of funds into needed public-private, regional, community-based investment opportunities.

Impact Investing is an investment strategy that intentionally aligns the investments of a portfolio, organization, or fund with the mission of that organization (or family or fund). It seeks to provide a financial return and a positive social and/or environmental impact. Impact Investors can be classified in three main categories: Impact First (primarily seeking to maximize impact while secondarily expecting financial returns if any, i.e., the grant), Investment First (fiduciaries primarily seeking market-rate or premium returns and secondarily (if at all) seeking a positive social or environmental impact); and Catalyst First (seeking to give or invest to collaborate to build the impact investing industry and infrastructure).

We hope that the Impact Investing portfolio development process described in this research can be adopted by a broad range of organizations who seek to align their investments with their mission while also adhering to their fiduciary duty to serve the best interests of the fund, generally interpreted to mean maximizing returns for a given level of risk. We determined that there are several characteristics to achieve to assure that our fiduciary standards were upheld: (1) have low fees, (2) use a rules-based and objective process, (3) be implemented through professional, registered investment advisors, (4) be monitored through a prudent, standard due diligence process based on traditional benchmarks, and (5) expect market-like returns.

By following a step-by-step process, beginning with a clear definition of the goals and mission of the UWBA, we identified a number of investment themes that would be aligned with a poverty alleviation mission. Those themes helped identify investable opportunities, securities, and funds. UWBA research and consensus identified the social drivers that alleviate poverty, such as job creation, and corresponding objective criteria were identified. This resulted in the creation of the "Bay Area Employers" index of companies headquartered in the San Francisco Bay Area, including many large employers that generally support the mission of UWBA. We determined a series of social criteria that would be proxies for identifying companies that could be classified as being "good employers," having "good management," and behaving as "good environmental stewards" in the Bay Area. We ranked those criteria and used objective data sources to identify companies that rated well in these criteria. Using computer-driven portfolio optimization programs, we developed a portfolio of stocks that would maximize the aggregate custom ESG score while minimizing tracking error to a standard benchmark, the Russell 3000. The resulting equity portfolio, of which 75% is headquartered in the Bay Area, would be overweighted in the companies whose practices were aligned with good environmental practices (E), positive employee relationships (S), and good governance (G). Being optimized, the portfolio would exhibit risk and performance expectations similar to the Russell 3000, with a less than 2% tracking error (1.64%). A fixed-income portfolio was identified that would earmark San Francisco Bay Area regional bonds such as Affordable Housing and Redevelopment Agency bonds, local GNMA and FNMA single and multifamily mortgages, some special community development (Small Business Administration), and corporate (Salvation Army) bonds, all benchmarked against and tracking the Barclays Aggregate bond index through a large, national CRA (Community Reinvestment Act) qualified diversified bond fund.

The San Francisco Bay Area economy is uniquely robust in its ability to be home to the second largest concentration of Fortune 500 companies (after New York), as well as being a center of innovation and growth, cultural diversity, and a concentration of world-class educational, financial, and entrepreneurial institutions and people. As the nineteenth largest economy in the world, the San Francisco Bay Area will need to continue to invest in itself to stay competitive and deliver cutting-edge thought, product, and service innovation. Identifying how fiduciaries can invest locally, in stocks, bonds, infrastructure, real estate, and private markets regionally, can provide a new source of funds for investment in Bay Area competitiveness into the future.

Impact Investing for Small, Place-Based Fiduciaries: The Research Project Initiated by the United Way of the Bay Area

Introduction

In the summer of 2010, a United Way of the Bay Area (UWBA) board member asked the investment committee about its Socially Responsible Investment (SRI) policy and its implementation for the endowment fund and operating reserves. This newly formed investment committee had just completed the creation of its Charge, Investment Policy Statement and By-laws but had not adopted any clear guidelines for screening the equity portion of the portfolio for social values.

Traditional socially responsible investing is based on excluding certain companies whose products or activities are deemed to be contrary to some fundamental beliefs of the organization. The Investment Committee would need to develop and incorporate a set of values that would align with the mission of UWBA, which is to reduce poverty in the San Francisco Bay Area. We formed an ad hoc committee to research how to add the appropriate value system and model a prudent portfolio. Our early research uncovered updated information about socially responsible investing and its performance results over two decades. Our research also uncovered a newer strategy called Impact Investing.

Impact Investing

Impact investing is a broadly defined strategy that intentionally seeks to combine prudent financial returns with positive social impact by aligning the organization's investments with its mission. Impact investing intentionality can be applied to all the assets in the portfolio, not just equities, and in our case would aim to have an impact specifically on poverty in the San Francisco Bay Area, our local community.

Our existing investment policy was vague on the details of socially responsible investment criteria. The Board had not given any direction as to which values would be appropriate to place on a portfolio of an organization whose mission was to alleviate poverty in the Bay Area. We offered to identify a process to model a unique portfolio that would align our investments with our mission as well as meet our fiduciary duties. It proved to be more than simply developing a process to customize our portfolio with value screens that align with our mission and testing that portfolio against traditional risk and return measures. We were also concerned whether such a portfolio would still meet our fiduciary duties without sacrificing investment performance. This report is the result of that investigation and ultimately recommends a unique and prudent portfolio designed to align with a mission to alleviate poverty in the San Francisco Bay Area.

Fiduciary Duty

Fiduciary Duty has a long tradition in our legal structures worldwide. It is based on the belief that those who manage assets for the benefit of others should be held to a high standard of behavior, be impartial and loyal to the present and future beneficiaries of the fund, and attend to the process of management of those assets with prudence.

Fiduciary duty breaks down into the Duty of Loyalty and the Duty of Care. Under the Duty of Loyalty, fiduciaries are generally required to discharge their duties (a) solely in the interest of participants and beneficiaries; (b) for the exclusive purpose of providing benefits; (c) impartially taking into consideration differing interests of various participant and beneficiary groups, and under the Duty of Care (or the Duty of Prudence) standard; (d) with the care, skill, and prudence exercised by similar fiduciaries, including as to diversification of investments; (e) incurring only costs that are appropriate and reasonable; and (f) in accordance with governing law and documents. (National Conference of Commissioners on Uniform State Laws, 1997).

Best practices for fiduciaries of institutional assets include developing policies and documenting the processes for management, delegation, and oversight of the funds and their purpose or mission. Best practices also include policies for avoiding, disclosing, or dealing with potential or perceived conflicts of interests. Keeping the interests of the fund foremost in the decision-making hierarchy is the cornerstone of fiduciary duty.

As wealth has become more concentrated in large pools of assets managed by fiduciaries, the interpretation of fiduciary duty has evolved. As recently as the 1970s, it was considered imprudent for some fiduciaries to invest in the stock market. Modern portfolio theory has contributed heavily to the evolving interpretation that maximizing returns is the sole focus of fiduciary duty and prudent behavior. Recent market distortions, however, revealed the shortcomings of relying on standard diversification tools for risk management and raises intergenerational equity issues under current investment practices. For example, investors cannot diversify away the risks inherent in climate change with traditional financial theory using a variety of asset classes. Instead, fiduciaries ought to consider the long-term implications of incorporating environmental, social, and governance (ESG) issues into their polices. It stands to reason that while short-term investors may not regard ESG issues highly, long-term investors are obligated to provide sustainable benefits over generations. "Fiduciaries need to overcome the tendency to allocate capital based solely on historical practices and approach sustainable investing from a forward-looking, risk management and value creation perspective" (World Economic Forum 2011a). Globally, more and more investors are tending to "consider any factor which may materially affect the sustainable long-term performance of the investment, including those of an environmental, social and governance character" (Preamble, Pension Funds Act, South Africa 1956).

ERISA (Employees' Retirement Income Security Act) and the Department of Labor (DOL) have defined the required standards of behavior for trustees of employee-benefit plans since the early 1970s, and the interpretation of those standards continues to evolve. In 1994, the DOL ruled that incorporating social or targeted economic criteria into an investment decision did not violate fiduciary duty so long as "the investment provided the same rate of return at the same level of risk to comparable investments available to the plan" (Wood, Thornley, Grace: "Impact at Scale", 2012).

Nonetheless, current fiduciary expectations still are defined by tracking performance against traditional standard benchmarks. So working within this narrower point of view, the committee agreed to seek evidence that we could build a portfolio that would be "economically indistinguishable" from a traditional portfolio but that could also be aligned with our mission.

As fiduciaries of an endowment fund, we are guided by UPMIFA (Uniform Prudent Management of Institutional Funds Act), which dictates our standard of behavior and our requirement to consider a variety of factors in setting the investment policy and spending policy for the endowment fund, i.e., the characteristics of the institution itself, its duration and preservation, its purpose, general economic conditions, inflation (or deflation), and its other resources. Among the unique characteristics of organizations like UWBA that are tied to the United Way brand, there are key identifying points: workplace giving is the predominant fund-raising model, relationships with employers is a key to donations, operations and grants consume fund-raising each year, and, in our case, prudent levels of reserves have been built. The UWBA endowment fund is small, liquid, and currently is not a big contributor to revenue to cover operations. Consequently, our research would focus on a stock and bond portfolio that would be aligned with the mission and would be expected to perform in-line with traditionally built and benchmarked portfolios.

The Evolution of Impact Investing

Early white papers on impact investing written by teams from the Rockefeller Foundation, J. P. Morgan Social Finance, Goldman Sachs, Global Impact Investing Network (GIIN), SRI research by Lloyd Kurtz and Meir Statman, Pacific Community Ventures' Insight and Harvard's Hauser Institute for Responsible Investment, and others provided basic background for understanding impact investing. These strategies are being developed to meet the growing demand by more investors for financial instruments that offer a competitive financial return and positive outcomes in social, environmental, and corporate governance issues. Investment products and services, from green hedge funds, social enterprise venture capital funds, sustainable infrastructure, shareholder activism, and governance equity funds and strategies are available, providing direct or indirect impact on different sectors of global and domestic issues. Microfinance and micro-lending globally and affordable housing and redevelopment bonds domestically are some of the earliest, largest, and most successful examples of impact investing at work in the markets today.

Early in the last century, faith-based investors applied Socially Responsible Investing (SRI) screens to their public equity investments to exclude companies whose policies or products were contrary to the beliefs of the organization:

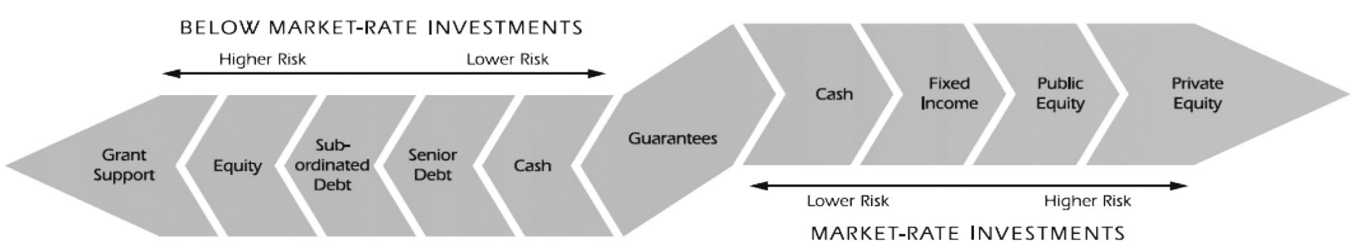
avoiding companies that behaved poorly (apartheid) or made “bad things” (like tobacco products, bombs, alcohol, etc.). Such screens were believed to limit the available universe to the “good” companies by restricting the potential investable universe to a smaller set, resulting in higher tracking error against benchmarks and potentially lower returns. Recent studies* of 18 years of SRI index performance indicate neither a negative nor positive alpha from SRI screens: the long-term returns are competitive (Lloyd Kurtz, Portfolio Manager Series, “The Stakes Go Up in Social Investing: New Evidence, New Controversies”, CFA Institute, 2010).

Fortunately, in the past couple of decades, simple negative screening has evolved to be more proactive. These newer Environmental, Social, and Governance (ESG) strategies are applied across all asset classes with a variety of structures and targeted impact. Now it can be easier for asset owners (pension plans, foundations, endowments, private portfolios) to align the objectives of their investments with their own values and missions, addressing such issues as mitigating climate change, improving water quality, or alleviating poverty conditions.

Fiduciaries are required to seek market-rate returns (and not sacrifice the expected return for a positive impact), and they should not consider investments that would be contrary to the current due diligence, asset allocation, and investment policies in place. There are many large asset pools, both private and public, that are successfully integrating their risk-and-return expectations with the goal of channeling some of their capital toward investments with a particular intended (though nonfinancially quantifiable) impact (for example CalPERS governance and infrastructure portfolio activities).

As shown in the diagram below from the F. B. Heron Foundation, impact investing strategies stretch across a continuum of investment opportunities. Traditional investing is at one end of the spectrum, offering a market return/ no intentional impact, while the opposite end of the continuum would be the grant: no financial return, all impact. Within each asset class, and with different combinations of returns, risks, and liquidity, impact investments can be viewed along the continuum. Market return vehicles, such as equity, fixed-income, and alternatives (private equity, hedge funds, etc.), would share space on one side of the scale, while below-market rates of return investments like Program Related Investments (PRI), Mission Related Investments (MRI), and grants share the other side. Some investors, like fiduciaries of retirement assets, will be looking only at the market-return side, while private foundations may be able to consider below-market return opportunities like PRIs or supporting grantees in unique ways with additional capital. Public-private partnerships could provide investment deal structures that offer a range of financial returns to the participants who combine their resources for a common positive impact.

THE F.B. HERON FOUNDATION’S CONTINUUM OF MISSION-RELATED INVESTING



Still in its early stages, the Impact Investing community is addressing the issues of public awareness, impact measurement, policy development, product development, and collaboration between investors and the creators of investment strategies. Each major asset class brings unique structures and potential impacts, so that some level of Impact Investing could be applied across all parts of the portfolio and all categories of targeted impact: for example, sustainable communities, environmental (clean energy, climate change, water), and social (education, children’s health, etc.) issues.

Impact Investor Profiles

Impact investors can be sorted into three main groups. Investment First investors are those whose primary focus is on the return side. Impact First are those who primarily seek positive social or environmental impact with their investments. The third group, Catalyst First, includes those who want their investments to act as a catalyst that will bring other investors into collaborative partnerships or help build the infrastructure of this emerging industry (Georgette Wong, "Insights and Innovations: A Study of Impact Investing and Instutional Investors", Secretary Hillary Clinton's Global Impact Economy Forum: Investment, Innovation and Impact, 2012). Those who are fiduciaries over institutional and trust assets will be considered to be Investment First impact investors who must primarily seek comparable financial returns and, secondarily, impact.

Public Equity Portfolios

Equity markets give us a clear way to "vote our dollars." The public equity space has often been the largest asset class in our institutional portfolios. It provides investors with liquidity, growth (inflation protection), and transparency in pricing. Equities may be less efficient at being measured for direct impact, but because we as shareholders get to vote our proxies, shareholder activism can be a powerful force for change in corporate behavior. Many large shareholders, like CalPERS, are active in the public equity sector through shareholder activism: voting proxies, submitting resolutions, and working with management for long-term positive change.

Other impactful public equity strategies have evolved to include proactive, sustainable investing strategies that encompass more social, environmental, and governance issues. For example, funds can own companies that are developing products, technologies, and services with positive environmental impact. Fortunately, more recent academic studies are finding linkages between strong corporate ESG programs and good stock performance: good corporate ESG management can lead to good risk mitigation, which can be indicative of a company's ability to respond to long-term trends and maintain a competitive advantage. Consequently, and the Department of Labor supports this, fiduciaries can include this kind of additional criteria, such as potential impact and ESG factors, in choosing investments without sacrificing our fiduciary responsibility to get comparable risk-adjusted returns.

Investment strategies and mutual funds are now offered in many flavors of ESG or Sustainability. It requires some corporate soul-searching to identify both the broad mission and the values of the organization as well as the process for implementing those values with investment vehicles. Appropriate due diligence is needed to align the values and mission of an organization with the investment objectives of the chosen funds and strategies. Some new websites and databases collect information on investment vehicles in each asset class that offer a combination of financial return and social impact.

Fixed-Income Investments

Fixed Income is usually a big portion of our portfolios. In the past, there were limited opportunities to use our fixed-income assets to make a social impact. Now there are more and more bonds that can give us the attractive aspects of owning fixed-income securities, like the promised coupon (yield), within a specific time frame (maturity), and within an understandable, quantifiable risk level (default risk), and with the added benefit of some positive impact. Some of these impact-oriented fixed-income investments provide liquidity directly to certain projects, such as affordable housing, micro-investing/micro-lending, or global green bonds. We are likely to get better metrics from our fixed-income investments about impact (such as the number of affordable housing units or clean water systems built) than we can in the public equity space.

Knowing the terms of the Impact bond portfolios will make it easier to know where these investments can fit in our asset allocation (short or long duration, domestic or global, investment grade or high yield). These assets can continue to act as a diversifier and lower the risk of the entire portfolio because they have low correlation to and less volatility than equities. Understanding these attributes within our whole portfolio context is part of the necessary due diligence process. When we monitor the portfolio and performance against its benchmarks over time, we can track the impact as well.

Alternative Investments

Sustainable/Impact/ESG investment strategies can be found in private equity funds, loan funds, hedge funds, venture capital, and other funds of funds vehicles. In the Alternative space in portfolios, we can often see the direct beneficiary of the capital investment: R&D for vaccines, green-and-clean tech development such as solar, electric cars, and community outreach programs and providers. Collaboration between private and public investors may also yield different investment structures with different risk characteristics that achieve common goals, such as a public-private partnership that combines affordable housing, economic development, and open space acquisition and protection.

Impact Measurement and Geographic Focus

Different investing organizations (asset owners) will be challenged to define their desired outcomes when they try to align the investment objectives of a particular investment strategy with their missions. Databases of objective sources of ranking criteria help in developing the measurement of corporate sustainability and responsibility. Standards are developing for comparison and measurement of impacts that investors can use in their due diligence. Additionally, the geographical focus of both the investor and the investment strategy can be a large factor in identifying the right fit between investor and investment. Some organizations and some investment strategies are more global in nature, while others are specific to a certain geographical region.

Also sometimes called double or triple bottom line investing, impact investing, in its many forms, is being embraced by leading private and public investors. The current demand for such strategies is estimated at $120 billion, but that still represents only a very small percentage of the approximately $30 trillion in total global financial assets (Nick O'Donohoe et al., "Impact Investments: An Emerging Asset Class", J.P. Morgan Global Research, 2011). As demand for such investment vehicles grows, so will the inventory of such opportunities grow across all asset classes. Collaboration between investors and product providers can help funnel global capital to new and sustainable business practices, which can lead to long-term solutions to serious issues at the community, national, or global level. Redirecting even some of the liquidity of traditional investment portfolios into sustainable companies, innovative products and services, or creative solutions to existing social problems could have a significant impact on the speed of improvement in these areas. Following normal existing due diligence and investment practices and policies, fiduciaries can implement impact investing opportunities into their portfolios without sacrificing return expectations or diversification benefits.

The Research Study for the United Way of the Bay Area

In 2010, UWBA introduced a bold goal. It announced that its aim was to cut poverty in half in the San Francisco Bay Area by 2020. To achieve this goal, UWBA developed a strategic plan and a roadmap for the work and began to organize partners within a Collective Impact model so as to address the goal in a concerted and powerful way. Among the first program innovations launched by UWBA were SparkPoint Centers located throughout the Bay Area. These centers provide bundled services to clients reaching for financial stability. SparkPoint joins a continuum of United Way programs that aim to move people out of poverty, including its Earn It! Keep It! Save It! free tax program, 211 helpline, MatchBridge youth-employment program, and sustained policy and advocacy. The investment committee was tasked with studying and outlining an objective process and model portfolio that would align the small endowment fund with UWBA's poverty-alleviating mission.

Recruiting the Ad Hoc Impact Investing Committee

"UWBA is forming an Ad Hoc Committee to investigate impact investing in our endowment portfolio. Impact investments provide a positive social impact, as well as a financial return. This Committee will review and develop a set of recommendations regarding the types of investment options, the criteria for determining and measuring social impact, and the issues around the implementation of such investments. In addition, this Committee would develop a policy that could coordinate investments with the UWBA mission for positive social impact and could overlap with various programs in UWBA's grant-making efforts."

Through this e-mail to the investment committee, finance committee, staff and board members, we attracted our new committee members, including most of the investment committee, some senior UWBA staffers, and four members from the UWBA Board of Directors from finance, investing, venture capital, and nonprofit management. We identified several implementation issues:

- Are all asset classes available?
- Do we carve out a specific portion of the portfolio?
- Do we try to implement some sort of impact investment expectation in all asset classes across the board?
- Could we add Impact Investing criteria to investment manager searches in all asset classes?
- Could we add impact investments to our Alternative allocation (which does not yet exist)?

We recognized that we would need to set appropriate expectations for returns, risk, time frame, and impact for our model portfolios. In some cases, we should expect a ten-year time frame for return objectives and impact goals to be fully realized, much like private equity and venture capital. By consensus, the other criteria we identified included:

- The mission is reducing poverty in the Bay Area by half by 2020
- Accept no sacrifice on (market) returns: expect comparable market rates of return
- Consider liquidity, be Bay Area–centric
- Require professional management/regulated financial intermediaries
- Develop a strategy that is scalable, transparent, low cost, and objective
- Support the UWBA prudent spending policy

We also noted the following implications:

- The funds required to have any significant impact on poverty need a certain level of critical mass, not yet achieved by the current size of the endowment funds at UWBA, presently $4 million.
- New endowment funding might provide assets and liquidity to fund long-term investments in the mission as well as provide a current income for UWBA operations, freeing up fund-raising/development to seek mission-related gifts rather than operating gifts.
- UWBA is uniquely qualified to create collaborations of like-minded investors and pools of assets and other nonprofits whose mission is tied to poverty reduction.
- A broadly diversified portfolio could be modeled and tested, composed of investments across many asset classes that meet our fiduciary due diligence and return/risk expectations but that also are focused on reducing poverty in the Bay Area.
- Research into equity, fixed-income, micro lending, and alternative/private equity funds that support poverty reduction, community development, is necessary.

It was clear that the first step for any fund looking to add an intentionality to its investments to have an impact on the mission must develop a clearly articulated mission objective. Once the mission objective is clearly defined, the appropriate investment opportunities that support the mission rise to the top (and less time is wasted on unrelated due diligence).

Fortunately, the UWBA mission is clear: to reduce poverty in the Bay Area. It is also broad enough for us to consider a variety of options. Rockefeller Philanthropy Partners developed the grid below that sorts investment vehicles by mission orientation. Investment options are not yet available in each asset class for each mission category. Because we need to expect to earn a "prudent risk-adjusted market rate of return" to meet our fiduciary requirements, and because our portfolio is relatively small, we agreed on the need to be creative and consider liquidity, risk, and return, as well as the degree of direct or indirect impact potential of each asset class in building our expectations for a prudent portfolio.

Sample Portfolio Description

Illustrative Landscape of Impact Themes with Asset Class Exposures

Social, Environmental or Blended Impact Themes	Asset Classes				Asset Classes				
	Liquidity	Income & Wealth Preservation			Capital Appreciation & Wealth Growth			Inflation Protection	
	Cash / Cash-Alternatives	Notes / Other Debt Obligations	Bonds	Absolute Return / Low Equity Correlated	Public Equity	Equity Long / Short	Private Equity	Real Estate	Commodities, Timber & other Real Assets
Climate Change	Green Bank Deposit		Tax-exempt green bonds	CO_2 Trading	Positive & Negative Screening		Clean Tech Venture Capital	Green REITs	
Energy			Screened Corporate Bonds	Alternative Energy Project Finance	Exchange Traded Funds (ETFs)	Renewable Energy	Energy Efficiency Venture Capital		Sustainable Feedstocks
Water			Corporate Infrastructure Bonds	Water Treatment Project Finance	Unit Investment Trust, Closed End Funds	Water Funds	Water Technology Venture Capital		Water Rights
Community Development	Community Bank CDs	Foreclosure Repair		Microfinance Institutions Debt	Shareholder Proxy Voting		Community Development Venture Capital	Transportation — Smart Development Funds	
Social Enterprises		Social Enterprise Credit			Micro-Cap Listed Social Companies		Small & Medium Enterprise	Conservation / Ecotourism	
Health & Wellness				Structured Public Note			Consumer Product Venture Capital	Organic Farming	
Sustainable Development	Trade Finance Guarantee / Deposit		Smart Growth Municipal Bonds	Blended Debt Equity Hybrid Structures	Thematic Screening			Ranch Land, Agriculture	Sustainable Timber
Education	Linked Deposit / Guarantee		Charter School Bonds				Education Private Equity	University Green Building	

Rockefeller Philanthropy Partners: *Solutions for Impact Investors: From Strategy to Implementation*

The following tables provided the committee with a process to follow and to compare some portfolio structures and vehicles that we could eventually model.

Impact Investing Process*:		For UWBA:
1.	Articulate Mission and Values	Reducing Poverty in the Bay Area
2.	Create Impact Themes	Community Development Job Training/Employment Affordable Housing
3.	Define Impact	Quantify job growth, unemployment rates decline, etc.
4.	Develop Impact Investing Policy	Build diversified model portfolios by size—small, medium, and large portfolios Develop Investment Policy: asset allocation, liquidity, risk budgeting, spending, monitoring, etc.
5.	Generate Deal Flow	Gather universe of ESG/Impact investment managers in all asset classes, model portfolios
6.	Analyze Deals	Perform due diligence
7.	Evaluate Impact	Monitor results, financial and social impact, test performance and volatility

*Rockefeller Philanthropy Advisors

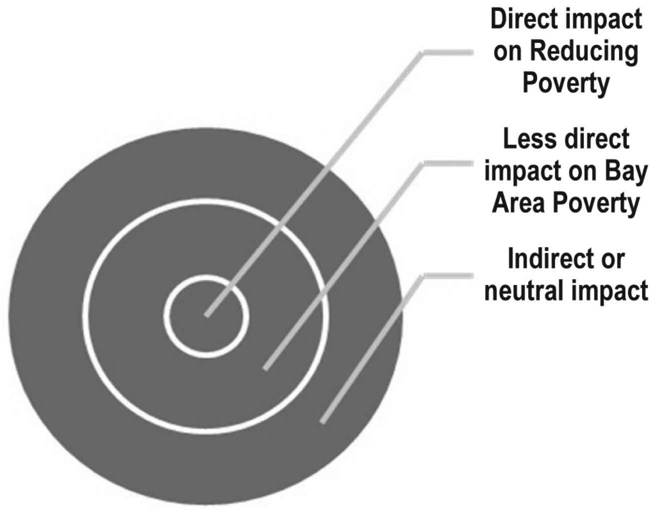
Possible future scenarios for larger portfolios:

Portfolio size	$10–20 million	$50–75 million	$100–200+ million
Asset Allocation (for example)	65% equities 35% fixed income	55% equities 25% fixed income 20% Opportunistic/GTA and/or alternatives	40% equities 20% fixed income 20% opportunistic/GTA 20% alternatives
Liquidity	100% liquid	10% illiquid	2/3 liquid, 1/3 illiquid
Risk profile	Like a 60/40?	Growth, income + capital preservation	Minimize risk of downside losses or negative returns?
Public Equities: domestic, international, emerging markets	ESG managers: Environmental, Social, Governance + Shareholder activism emerging markets equity portfolios? Custom portfolio of equities in Bay Area Companies/employers?		
Fixed Income: domestic, international, emerging markets	Deposits or loans to Community Development Financial Institutions, infrastructure bonds (power, sewer/waste management, hospitals, transportation, affordable housing bonds, water, redevelopment projects) green bonds, microfinance/micro-lending Corporate bonds in Bay Area companies, municipal bonds in Bay Area		
Special Mutual Funds	SRI ETFs REITs	Equities in Bay Area companies	
Private Equity Deals			Impact-oriented private equity funds.
Hedge Funds		Hedge funds or Fund of Funds	Other alternatives, poverty focus

Using the methodology of the step-by-step process, we identified several themes that could provide investment options while supporting the mission. Job creation and employment were the most visible and effective themes to combat poverty. Affordable housing and community development were also recognized as strong themes for alleviating poverty in our communities.

Our next goal then became finding appropriate investment managers and investment vehicles of portfolios of stocks and bonds that focused on the Bay Area. Our research and networking indicated that most existing impact investing strategies were part of the Alternatives sector of private and personal wealth-based portfolios, generally using private equity or private debt for targeted impact on a mission. Traditional investment consultants have relied on databases to find managers for the more liquid stock and bond strategies, but we doubted we could find alignment for our unique and geographically focused mission in some existing "off-the-shelf" SRI/ESG strategy. SRI/ESG/Impact databases are in their infancy in tracking mission and impact. Fortunately, in the Bay Area, we have access to deep resources from the graduate schools and their faculty, as well as brilliant financial engineers and investment advisory firms, for analyzing and back-testing model portfolios. Networking among these sources provided some possible solutions.

From the impact-measurement side, we chose the bull's-eye image: we would try to identify the appropriate metrics, knowing that the level of impact is different for different vehicles in different asset classes. To understand various poverty metrics, the UWBA staff provided social criteria information on the drivers of poverty to build into our scoring system. In identifying impact, we understood that it would likely be easier to identify an impact with fixed income than with public equity.



Sample Fixed-Income Portfolio Description:

The committee identified Community Capital Management (CCM), a fixed-income portfolio management firm with a unique solution for community impact investors through its CRA (Community Reinvestment Act) qualified fund: CRANX . Originally designed for banks seeking positive consideration under the Community Reinvestment Act, this fund is benchmarked to the Barclays Aggregate. Within this $1+ billion fund, CCM can earmark Bay Area bonds for our specific ownership, while we receive the risk-and-return results of a larger diversified fund.

For the United Way of the Bay Area portfolio, Community Capital Management suggested a variety of high-credit-quality fixed-income securities that support economic development in the Bay Area:

Targeted Mortgage-Backed Securities (PASS)

Custom created Fannie Mae, Freddie Mac, and Ginnie Mae MBS pools based on borrower demographics. These loans would be to low- and moderate-income families for owner-occupied properties. Credit screening includes reviewing LTVs (loan-to-value), FICO scores, and the borrowers' abilities to pay. The loans would be made to families residing in Marin, San Francisco, San Mateo, Alameda, Napa, Solano, Contra Costa, and Santa Clara Counties.

Multifamily Mortgage-Backed Securities (MFMB)

Fannie Mae DUS and Ginnie Mae Project Loan and Construction Loan certificates financing affordable rental housing, for example:

- Almaden Valley is a 100% affordable rental development in San Jose that backs up to permanent open space, is adjacent to a city-owned regional park, and is located a block away from a light rail station. The proximity to existing transit corridors is consistent with the city's Smart Growth Policy. Developed in conjunction with a single-family development, families enjoy shared facilities, including a pool, community center, and tot lot. 100% of the 144 units at Almaden Lake Apartments are restricted to residents with incomes at or below 60% of area median income.
- Hayes Valley is a Hope VI mixed-income family housing development located in the Western Addition, three blocks from the San Francisco Civic Center. It replaces 294 small severely distressed public housing units. Hayes Valley Redevelopment rebuilt a total of 449 bedrooms in family apartments to replace the original 463 bedrooms in predominantly studio and one-bedroom units. The new housing includes 195 Victorian-style townhouses and flats for families. 100% of the 195 units are restricted to residents with incomes at or below 60% of area median family income. The project's land is being leased to the private development partnership for 57 years as a condition of receiving private funds (Low Income Housing Tax Credit equity and from an FHA insured first mortgage). Since the State of California has recently abolished Redevelopment Agencies, we are uncertain how such projects will be accomplished in the future, and what the impact might be on funding such projects and on building impact portfolios with fixed-income securities such as these.

Taxable Municipal Bonds (MUNI)

Taxable Municipal Bonds issued by state and local governments that finance affordable housing, enterprise development, and comprehensive community development, including environmental sustainability.

- City and County of San Francisco. The Bonds issued were to finance the construction, rehabilitation, and preservation of low-income housing and for general redevelopment purposes. The Agency is undertaking redevelopment in the eleven Project Areas: the Rincon Point–South Beach Redevelopment Project Area; the Yerba Buena Center Redevelopment Project Area; the Western Addition Redevelopment Project Area A-2; the Hunters Point Redevelopment Project Area; the South of Market Earthquake Recovery Redevelopment Project Area; the India Basin Redevelopment Project Area; the Hunters Point Naval Shipyard Redevelopment Project Area; the Embarcadero-Lower Market Redevelopment Project Area, the Federal Office Building Redevelopment Project Area, the Mission Bay North Redevelopment Project Area and the Mission Bay South Redevelopment Project Area.

Asset-Backed Securities (ABS)

Comprised largely of SBA (Small Business Administration) guaranteed loans and pools that finance enterprise development to small businesses.

- United States Small Business Administration bonds, which financed a loan to CityBloom Inc., located at 500 –12th Street in Oakland, in a low-income census tract. Annual revenues for this business were $940,000. This business is located in a HUBZone tract. CityBloom employs nine workers. The HUBZone Program promotes job growth, capital investment, and economic development to historically underutilized business zones by providing contracting assistance to small businesses located in economically distressed communities.

CMOs/REMICs (CMBS)

Structured cash flows through a REMIC structure backed by Ginnie Mae Project Loan and Construction Loan certificates that finance affordable rental housing.

Ginnie Mae Pool within Ginnie Mae REMIC Trust finances El Bethel Terrace, an affordable rental property for seniors located at 1099 Fillmore Street in San Francisco; 100 of 101 units receive Section 8 Assistance. El Bethel Terrace resides in a low-income census tract. The loan to El Bethel Terrace refinances an existing loan insured under Sections 202/811. The Section 202 program helps expand the supply of affordable housing with supportive services for the elderly. It provides very low-income elderly with options that allow them to live independently but in an environment that provides support activities such as cleaning, cooking, and transportation. The Section 811 program allows persons with disabilities to live as independently as possible in the community by increasing the supply of rental housing with the availability of supportive services. The program also provides project rental assistance, which covers the difference between the HUD-approved operating costs of the project and the tenants' contribution toward rent. El Bethel Terrace is managed by Christian Church Homes, the largest nonprofit low-income senior housing provider in Northern California.

CCM also included *a Salvation Army (bond) issue*, as a corporate bond issue example (IND). The proceeds of the Bonds were used by the Salvation Army, Western Territory, to refund a portion of the Corporation's outstanding Flexible Term Notes. The Salvation Army is an international religious and charitable organization that operates in the United States as four divisions. The Corporation is the principal corporate instrumentality in the Western Territory of the United States for the Salvation Army. The Western Territory is incorporated in the State of California with corporate headquarters located in Long Beach. The Western Territory's centers of operation include adult rehabilitation centers, divisional headquarters, institutions, corps community centers, and service extension units. In the San Francisco Bay area, the Salvation Army USA Western Territory offers the following services:

- Adult Rehabilitation Centers located in Oakland and San Francisco
- Disaster Services, Domestic Violence Services, Emergency Assistance; Financial Assistance, Emergency Shelter, Food and Nutrition Programs; Family Counseling Services and Housing Services are offered at the Alameda County Command Office in Oakland;
- Family Counseling Services, Older Adult Services, and Youth Services are offered at the Oakland Garden Center

- Day Care is offered at the Oakland Booth Center; and Family Counseling Services, Health Services, Older Adult Services, and Youth Services are offered at the San Francisco Asian American Yerba Buena Community Center.
- The short-term balances of the CCM Fund's fixed-income portfolio are invested in cash and equivalents, such as short-term banking deposits that can be placed with local community development financial institutions (CDFIs). The UWBA endowment could also seek short-term investments in CDFIs in the San Francisco Bay Area.

Conclusion: The committee liked both the expected financial return patterns and the impact these specific bonds implied for our community. The committee decided to do further due diligence on this firm and its strategy for possible inclusion in the portfolio. (See the Appendix for more information and disclosures on CRANX and Community Capital Management).

Developing the Equity Portfolio

Developing the equity portfolio was more challenging because there was no existing fund that was focused solely on the Bay Area and specifically on a poverty-alleviation mission. The "Bay Area Employers" concept that we developed from our step-by-step process evolved into defining a universe of companies that are headquartered in the Bay Area. Developing simple standardized rules for inclusion or exclusion in the universe would mitigate the risk of politics playing in favor of including or excluding certain companies. This universe of Bay Area companies could be tested to assess which attributes contribute to risks and returns as compared to those benchmarks used in traditional portfolios.

Defining the Universe

As we focused on companies headquartered in the Bay Area because they tend to be large employers, we acknowledged there is at best an indirect impact to alleviating poverty through owning public equities. We were fortunate to discover that in 2003, the San Francisco Chronicle and Bloomberg created the Bloomberg Bay Area Index (BBACAX) of companies headquartered in the Bay Area. As of June 2011, it included 383 companies, weighted by market capitalization. The largest five members are Apple, Chevron, Oracle, Google, and Wells Fargo and these five companies made up 50% of the index.

Analyzing a benchmark is critical to building appropriate portfolio expectations. The BBACAX index underperformed the S&P 500 in the one-year period ending 6/30/11, but it had outperformed over three and five years, with a higher standard deviation. Tracking error to the S&P over five years is 8.5% with its current cap-weighted construction.

	as of 6/30/11					
	1 - Year		3 -Year		5 - Year	
Description*	BBACAX	S&P 500	BBACAX	S&P 500	BBACAX	S&P 500
Anlzd Return	26.94	30.69	7.89	3.34	4.49	2.94
Anlzd StdDev	17.66	13.17	24.47	20.91	21.86	17.73
Beta	1.31	1.00	1.11	1.00	1.15	1.00
Sharpe Ratio	1.52	2.32	0.31	0.14	0.12	0.06
R-Squared	95.09	100.00	89.29	100.00	86.30	100.00
Anlzd Alpha	-10.35	0.00	4.64	0.00	1.68	0.00
Info Ratio	-0.66	#N/A	0.55	#N/A	0.18	#N/A

(*Definitions of the above ratios can be found at the end of this paper.)

Aperio Group, a Bay Area institutional investment manager and developer of custom portfolios designed to track institutional index benchmarks, worked with the committee to investigate using the Bloomberg Bay Area Index (BBACAX) as the underlying universe to build a custom indexed portfolio. With Aperio's assistance, we could analyze several iterations of the index and identify an optimal approach for our fiduciary purposes, including understanding the "costs" of the geographic focus and social criteria and evaluating the trade-off between screening intensity and impact on performance, working to balance values and performance.

In addition to companies that are headquartered in the Bay Area, there are many large employers who might be included for geographical diversification and industry and sector exposure, and who are supporters of UWBA. We reviewed the cost/benefit of including some additional companies, such as Bank of America and PacTel, now AT&T (both formerly headquartered in the Bay Area) as well as some large employers that are foreign-owned companies, such as Genentech (Roche) or Fireman's Fund (Allianz):

Roche (Genetech)	*BNP (Bank of the West)*	*Comcast*
Franklin Templeton	*Marriott*	*Allianz (Fireman's Fund)*
Fair Isaac	*ATT*	*Bank of America*
UPS	*Macy's*	*Costco*
Western Digital	*Nordstrom*	*BNY Mellon*
Abbott Labs	*Tesoro*	

Testing the Portfolio Structure

Aperio created a few portfolios using both the additional global companies and using just domestic companies, and commented on the results of the forecast tracking errors versus the S&P 500 for each portfolio shown below:

Model Equity Portfolio Structure

¥ Model portfolios:	¥ Tracking Error to S&P 500	
	BBACAX +15	BBACAX
¥ Cap Weighted	5.39%	6.17%
¥ Equal Weighted	15.68%	15.81%
¥ Optimized	2.68%	2.82%

The results indicate that it is possible to get a low tracking error (below 3.0%) using an optimized portfolio. An optimized portfolio tries to mirror the entire U.S. stock market (in this case, the large-cap portion represented by the S&P 500). By way of comparison, surveys of major pension consultants accept an expected average tracking error of 5.0% for active equity managers.

Aperio: "The forecast tracking error numbers provide a good estimate of how different a portfolio will be from the benchmark, which is important in terms of how the investment committee views the risk of such a portfolio. It's a measure of deviation around the benchmark return itself, with the same likelihood statistically of ending up higher or lower than the benchmark. If the index returns 8.00% in a given year, then about 68% of the time a portfolio would be expected to perform within one standard deviation. For example, for the Global Optimized, the return is predicted to be between 5.32% (one standard deviation negative, or 8.00 - 2.68) and 10.68% (one standard deviation positive, or 8.00 + 2.68) roughly 68% of the time. Normally performance would be within two standard deviations about 95% of the time. These results show that the cap-weighted and equal-weighted portfolios would vary from the S&P 500 significantly more than the optimized portfolio. While these results aren't necessarily conclusive one way or the other, they show the possibility of a low tracking error for an optimized strategy as the underlying structure of the portfolio."

Below is a spreadsheet with data on sector exposure and market cap. The optimized Bay Area Index is fairly broadly diversified, with some slight variations, such as the lack of telecommunication services in the Bay Area. Indeed, the San Francisco Bay Area is the nineteenth largest economy in the world and is surprisingly more robust than we had thought it would be. These results encouraged us to believe that the BBACAX would be a useful proxy for Bay Area job creators and employers for our mission's purposes.

Model Sector Allocations

GICS Sector	Optimized BBACAX – HQ	S&P 500
Consumer Discretionary	10.14%	10.60%
Consumer Staples	7.20%	10.50%
Energy	13.18%	13.10%
Financials	16.36%	14.75%
Health Care	13.50%	11.42%
Industrials	5.48%	10.95%
Information Technology	27.09%	18.72%
Materials	0.55%	3.65%
Telecom Services	0.00%	2.93%
Utilities	6.52%	3.37%
Wtd Avg Mkt Cap	$ 84 billion	$ 94 billion

Adding the other major employers identified above to the BBACAX gave us a smaller tracking error when optimized to the S&P and provided us with additional sector diversification. We agreed that the BBACAX + 15 would become the starting point for our model custom universe.

Adding Social Criteria

Having established the universe (the BBACAX + 15 custom universe) and portfolio construction methodology (optimization), the equity portion of the portfolio could now be further refined to include some ESG values, screens, and criteria that align with our poverty mission, which was our original assignment.

Our challenge was to identify an objective, consensus-based process for adding certain value screens or scores to the equities, and to analyze the effect of those screens and scores on the risk-and-return expectations. The Aperio Group and its research partner, IW Financial, have a worksheet that guided us in thinking about what values criteria and what weightings for those criteria would be most aligned to our mission. Our answers to this questionnaire yielded a consensus of the top issues that should be included in a regional poverty alleviation overlay to the equities side of the model portfolio. Not all issues available are relevant to a poverty mission (such as animal testing.) By focusing on the handful of issues that are reflections of the ways in which business can affect poverty, we can more closely align the portfolio with our antipoverty values. It was useful to prepare for this work by sharing UWBA research and its roadmap on the drivers of and solutions to poverty. In the ideal world, the equity side of the model portfolio would be weighted toward investments in companies that demonstrate a commitment to solutions like those outlined in the UWBA roadmap and so would best fit the mission of reducing poverty in the Bay Area.

We needed to translate our values of how companies demonstrate their commitment to solutions to poverty, primarily as job creators and employers, into scores based on objective data elements. In our focus-group conversation, we began defining a “good company” as one that had strong, positive employee relationships, broad diversity and nondiscrimination policies, strong employee benefits and wage levels, one that is a good environmental steward in the Bay Area and is well managed and transparent. We wanted to measure, rank, and compare which companies that are good to work for would be a larger part of our portfolio: we would overweight companies that scored well in our criteria and underweight (or not include companies) that scored poorly.

Using the questionnaire, the focus group, some of whom were members of the committee and staff, identified the categories that we recognized as most relevant to good employment and governance practices. There are 25 categories in the questionnaire, with Corporate Governance acting as one set of criteria for 7 categories. Our collective answers revealed 8 categories that ranked highest on the combined “relevance rankings” and determined the weightings we would apply in the model.

The following table identifies those criteria that we believe are most relevant to alleviating poverty.

Highly Relevant to Poverty	Moderately Relevant	Low Relevance	Not Relevant

Job Creation
Labor Relations
Recognition (Corporate)
	Human and Employee Rights
	Workforce Diversity, including Sexual Orientation
	Environmental
	Corporate Governance Metrics
	    Auditing Practices
	    Board Accountability
	    Board Composition
	    Board Independence
	    CEO Compensation
	    Company Ownership
	    Shareholder Rights
	    Takeover Defenses
		Gambling	Tobacco
			Alcohol
			Adult Entertainment
			Animal Testing
			Bioethics
			Firearms
			Life/Choice
			Military
			Nuclear Power

We first agreed that our unique universe of Bay Area employers was representative of the most highly relevant poverty-reducing criteria: job creation. We then reached consensus by voting and weighting the criteria, giving the Highly Relevant categories double weighting over Moderately Relevant, which are double the Low Relevance weight. In our case, rather than have a low relationship to poverty for gambling (but not gaming), we determined that we would eliminate any company whose revenue from gambling exceeded 20% of total revenues. The research used to determine the scores is based on objective data culled from company, government, and industry information. We thought it important to narrow the list of relevant criteria to just a handful so that each criterion would have enough weighting to count as a contributor. Screening strategies that try to include too many criteria end up diluting all of them.

Criteria	Sample Data Elements*	Importance	Weighting	% of Total
Labor Relations	Evaluation of Relationships with Organized Labor	high	4	22%
Recognition	Workplace and Diversity	high	4	22%
Diversity	Workforce, Board, and Management	hedium	2	11%
Sexual Orientation	Nondiscrimination Statement on Same-Sex Benefits	medium	2	11%
Environmental	Toxic Release and Spills data	medium	2	11%
Human Rights	Global Sullivan and Global Compact signatories	medium	2	11%
Corporate Governance	Grades	medium	2	11%

*For more information about the data elements and sources, see the Appendix.

Consequently, ours is a custom scoring tool that weights 22% of the total score on Labor Relations, 22% on Corporate Recognition, and 11% for each of the other five categories: Workforce and Management Diversity, Sexual Orientation policies, Environmental (toxic release management), Human Rights, and Corporate Governance. (For more information about the definitions, metrics, and data elements, see IW Financial and the Appendix.)

Using a broad and deep research database of objective metrics from various government and corporate sources, Aperio mixes the scores from all the companies in the total universe, weighted by the UWBA custom ESG scoring system. To minimize tracking error, each company will be evaluated on its contribution to an overall high custom ESG score, as well as its contribution as a good diversifier and appropriate fit for the portfolio's optimal exposures versus the benchmark.

Once we determined which factors to include as screens/rankings, we directed Aperio's portfolio optimizer program to model a series of unique portfolios of Bay Area stocks that have strong scores in the identified categories. We evaluated the degree of tracking error created by those screens and scores. We had already learned that the geographic focus of the model portfolio produces some tracking error against the Russell 3000. By understanding and evaluating the different sources of tracking error, and by testing the tracking errors of a geographic focus versus social/governance scores, we would be able to refine the model portfolio so that it meets the goal of unifying and maximizing portfolio returns and community impact while keeping to our fiduciary duty.

Aperio ran several model portfolios that demonstrated the trade-off between social scores and tracking error. It was clear that as we increased the total ESG score for the portfolio, we also were increasing the tracking error. The geographic constraint was also analyzed for its contribution to tracking error and it was found to have a larger impact on tracking error than the social criteria. In order to find a balance between maximizing the social score and minimizing the tracking error, we graphed the model portfolios for each of three underlying equity universes: a Bay Area companies-only (100%) universe, a universe that is 75% Bay Area companies, and a universe that is 50% Bay Area companies. By adding companies that are headquartered outside the Bay Area, we could significantly reduce tracking error, but it could come with a potential "cost" of diluting the message of our Bay Area focus.

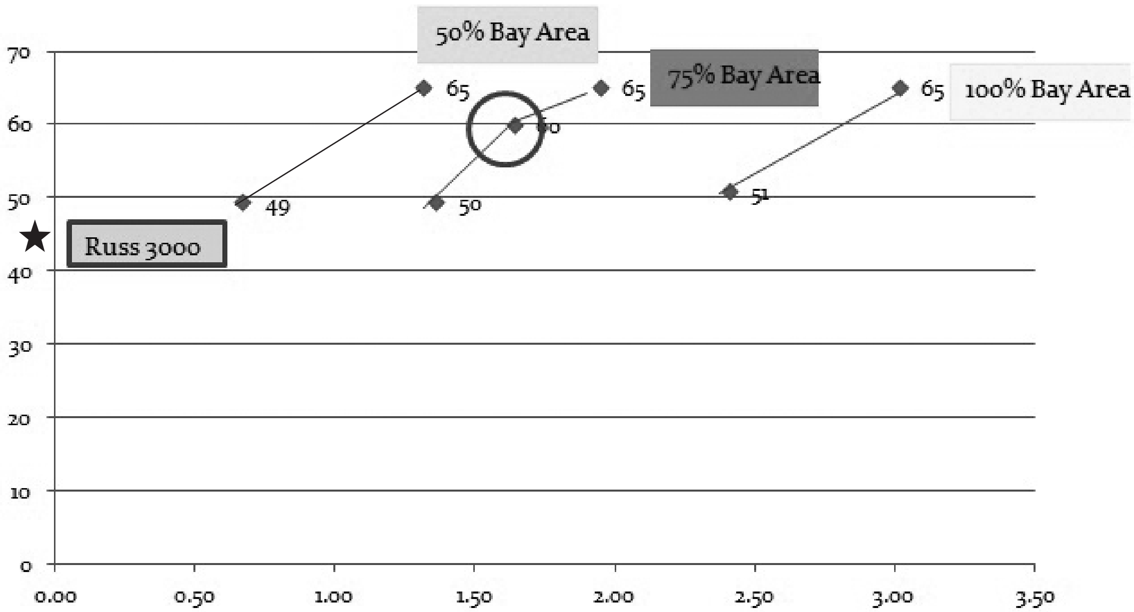
In keeping with our efforts to hold strongly to our fiduciary duty to maximize risk-adjusted return expectations, we understood that by accepting a too-large tracking error in favor of having a higher ESG score for the whole portfolio, we would run the risk of seeing large deviations in performance from traditional benchmarks that could cause us to abandon the concept entirely. Understanding that the trade-off is between pragmatism and idealism, we sought a balance in our approach.

Sample Portfolios:

	Bay Area 19%	Bay Area Only -100%		Bay Area Co's 75% of portfolio			Bay Area 50% of portfolio	
Screened Portfolio Version	R3000 Index	1	4	8	10	13	7	11
Benchmark	R3000	R3000	R3000	R3000	R3000	R3000	R3000	R3000
Model Universes	R3000 Index	BBACAX+15	BBACAX+15	BBACAX+15 +25% other	BBACAX+15 +25% other	BBACAX+15 +25% other	BBACAX+15 +50% other	BBACAX+15 +50% other
Universe - Holdings	2,940	252	252	1,982	1,982	1,982	1,982	1,982
Standard Deviation	20.43	20.57	20.65	20.48	20.52	20.49	20.44	20.47
Tracking Error vs. Benchmark, %	0.00	2.41	3.02	1.36	1.95	1.64	0.67	1.32
Model UWBA Social Score	46	51	65	50	65	60	49	65
Bay Area Weight %	19	100	100	75	75	75	50	50
Number of Holdings	2940	126	99	264	178	210	450	294
Average Market Capitalization, $Billions	87.9	80.0	93.2	89.0	89.0	89.5	89.8	91.6

Choosing the Parameters for the Model

¥ Custom ESG Scores, Tracking Error, Geographic Focus



It is interesting to note that the Russell 3000 has 19% of its universe in Bay Area headquartered companies, and has a custom social score of 46. The other model portfolios are graphed to show the trade-off between tracking error and social score for each of the three universes (100%, 75%, and 50%). The graph suggests a good combination of low tracking error (less than 2%) and a moderately high social score (60) comes from a portfolio that is 75% Bay Area headquartered companies and 25% in companies based outside of the Bay Area. This seems to be a reasonable compromise on the universe composition since there clearly are employers in the Bay Area that are not headquartered here, and we are well rewarded with a significant reduction in tracking error by expanding the underlying universe.

MODEL Equity Portfolio characteristics:

Universe	BBACAX + 15 + 25% other	Russell 3000 Index
Universe - Holdings	1,982	2,940
Standard Deviation	20.49	20.43
Tracking Error vs. Benchmark, %	1.64	0.00
Model UWBA Social Score	60	46
Bay Area Weight%	75	19
Number of Holdings	210	2940
Average Market Capitalization, $Billions	89.5	87.9

See the Appendix for sector weightings as of May 31, 2012.

Model Portfolio Performance Check

We asked Aperio for a performance check on the model portfolio and it reported the following results for the 13-month period beginning April 1, 2011, to May 31, 2012. For this short period, the overall portfolio returned a benchmark-like performance, as expected. (Backtesting portfolios over a relatively short time frame should be viewed for information purposes only. The 13-month period was the only time frame available from Aperio and we recognized that it offers no evidence that this portfolio would outperform in the future. We share the results with that in mind and expect that with the construction techniques used, we can anticipate a close tracking to the Russell 3000 or Barclays Aggregate.) We are able to review the sectors and attribution characteristics as to what factors contributed to and what factors detracted from the performance target.

A few highlights of the analysis:

Over the measurement period, the model equity portfolio outperformed by 0.16% (-2.84% vs. the Russell 3000 at -3.00%). (By comparison, the current endowment fund's equity portfolio using a multimanager, multistyle approach, produced a -9.61% return for the same period.)

- The bulk of the outperformance comes from asset-specific risk (1.01% vs. benchmark). This is the risk of holding assets at different weights than the benchmark index. Asset-specific risk shows us the return contributions that are not captured by factor exposures (e.g., industries or risk indices).
- Industries detracted 0.58% vs. benchmark. Being overweight Computer Hardware and Business Machines detracted 0.32% and being underweight Specialty Retailers detracted 0.24%.
- Risk indices detracted 0.26% vs. benchmark. The portfolio had lower exposure to Momentum than the benchmark, which detracted 0.18%.

The Fixed-income portfolio from Community Capital Management returned 9.61% for the 13-month period ending 5/31/12 versus the Barclays Aggregate return of 9.91% and the PIMCO Total Return fund's performance of 8.46%.

- The tracking error for the CCM fixed-income portfolio versus the Barclays Aggregate was .94% (much less than the PIMCO Total Return fund's tracking error of 3.97%), and for a five-year period the CCM portfolio tracked closer than PIMCO Total Return at 1.73% vs. 2.89%. The fund also provided a yield-to-worst of 2.30% vs. the Barclays Aggregate's yield-to-worst of 1.97% as of the end of May 2012. The correlation to the equity market (S&P 500) is lower than the benchmark's correlation (-0.07 versus 0.11). The CCM fund's down-market return over the last five years is -3.94% versus the benchmark's down market capture of -7.29%, indicating that it would be giving better protection in a rising interest rate and /or negative bond market.

Conclusions:

- It is possible to build strong portfolios focused on stock and bond investments in the Bay Area.
- Greater impact can be realized through the bond portfolio and someday through a private equity portfolio than through public equities.
- Following an objective process, unique social-values screens can be identified that align with mission and can be applied to the construction of an equity portfolio to promote certain values without sacrificing fiduciary duties.

Summary: UWBA Impact Investing Model Portfolio:

Financial return + social impact on poverty in the Bay Area

As we have seen, given the UWBA's focus on poverty, the concept of using investable assets as a tool to proactively impact the mission makes good sense–both from a financial aspect and from an impact aspect. Under the poverty umbrella, investments in affordable housing, job training and development, community loans, transportation, and other infrastructure development are all consistent with the mission. This committee began to investigate whether a viable portfolio could be built that would satisfy both the mission as well as the required risk-and-return objectives that a fiduciary must insist be achieved.

While current applications of impact investing by private foundations tend to limit the category to a small carve-out of overall assets, or to be focused on one asset class only, predominantly private equity, we believed that the largest impact would be to investigate investing the entire portfolio in poverty alleviation-related securities that would meet our fiduciary responsibilities of diversification and risk-and-return expectations, and we set out to test that theory.

One challenge in building a 100% impact portfolio is in understanding the degree of impact each asset class can have on the mission. As we first researched what expectations for impact we might have for each asset class, we recognized that some asset classes provide more direct impact than others. Fixed-income assets can be targeted to provide direct impact on poverty through specific bond offerings, particularly around affordable housing, community development, and infrastructure such as transportation-oriented development. Public equities, by contrast, provide indirect impact at best but are critical in maintaining a diversified, long-term growth-oriented portfolio. Shareholder activism, proxy voting, and governance monitoring are ways we can add impact to our equity portfolios and be aligned with our mission through working with employers for strong management and employment policies. Private equity deals are more likely to have a greater impact but are less likely to be focused on the Bay Area specifically or to fit in a very small portfolio.

A small endowment fund like UWBA's ($4 million) would necessarily need to focus initially on liquid investments like public stocks and bonds. If and when a larger portfolio was built, private equity could be added, increasing potential returns, diversification, and impact.

A model fixed-income portfolio was created by a specialty bond manager who found Bay Area mortgage-backed securities, affordable housing and taxable municipal bonds, Small Business Administration bonds, and corporate bonds (Salvation Army) to build a strong portfolio that would be expected to track the traditional benchmark, the Barclays Aggregate. With additional cashlike deposits in community development banks who reloan the funds for community development, a prudent fixed-income portfolio can be structured with a Bay Area focus on poverty alleviation.

For our equity exposure, we developed a universe of companies dominated by those who are headquartered in the Bay Area because they tend to be large employers, thereby helping to alleviate poverty, albeit indirectly, and tilting the portfolio to those employers who are known for strong employee relationships and policies.

With the help of a Bay Area investment management firm that specializes in creating custom portfolios we developed a model portfolio that tracks the Russell 3000 closely using this custom universe. The resulting optimized custom portfolio was found to have less than a 2% tracking error to the Russell 3000 index, which suggests that this portfolio has a similar risk level to the broad market and would therefore have similar expected returns, meeting our fiduciary duty to track traditional risk-and-return standards.

The impact of this portfolio can be measured through its investments as well as through the public attention that could be brought to the issue of poverty in the Bay Area and the investment needs we face to battle poverty. A small portfolio would have a small impact, but the public conversation could have a much larger impact on the future needs of the San Francisco Bay Area.

Implications of This Research from the Author's Point of View:

Impact of the Message: Influencing the flow of institutional investing: Public-Private Partnerships

The public conversation about an "Impact Bay Area" model portfolio could result in bringing other institutional investors into financial collaboration as well as alignment with the needs of the Bay Area and develop more flows of funds into solutions to some of these Bay Area issues. Indeed, the author believes that the message of a 100% impact investing strategy in an endowment fund might provide the most dramatic impact because of its potential to attract co-investors and new dollars to the mission. Co-investors like community foundations, public funds and private wealth in the Bay Area, and private foundations and endowments could be invited to invest alongside nonprofits in new housing, infrastructure, transportation, or community development opportunities.

The opportunity presented in the impact investing model portfolio's message appears to us to be enormous:

- A Bay Area–focused portfolio embracing impact investing could be a catalyst for attracting attention to the needs of the poor in the Bay Area as well as the benefit of impact investing as an option to support its mission.
- It could attract new dollars directly and indirectly to much-needed investments in Bay Area infrastructure and community development to alleviate poverty.

- It could influence the flow of institutional and private assets into Bay Area opportunities that would be otherwise invested globally and not locally. The Bay Area counties and cities (Alameda, Contra Costa, Marin, San Mateo, City and County of San Francisco, San Jose City Employees, and San Jose Fire and Police) have combined assets in their defined benefit plans totaling over $31 billion, and the community foundations of Marin, San Francisco, Silicon Valley, and East Bay would add billions more. Conceivably, encouraging them to allocate even a small percentage of these funds as co-investments alongside a Bay Area–centric impact portfolio would contribute a huge net new impact on alleviating poverty. Let's invest where we live.
- It could promote additional sources of revenues for nonprofits through the income produced by a larger endowment.
- It could be applied as a strategy for Donor-Advised funds at community foundations: "Invest in your own backyard. Help your community invest in the future."
- It could be a model for a retail investment family of mutual funds for like-minded investors (not donors) who wish to invest locally in this mission: call it the "Impact Bay Area" family of funds.

As a Thought Leader

A Bay Area impact investing fund could be a game-changer at a time when our traditional sources of funders, such as state and local governments and redevelopment commissions, cannot fund much-needed community-based projects. It could be a model for other organizations across the country to increase and influence investments that have an impact on our local communities and the people we seek to serve.

Please note:

The United Way of the Bay Area was the initial seed ground for this study. It will follow developments in this new field with interest. UWBA has not endorsed and does not sponsor any particular investment strategy at this time.

Appendices

1. Details of the Fixed-income Portfolio:

a. CRANX fact sheet from Community Capital Management

http://www.ccmfixedincome.com/files/2Q12%20Performance%20Summary%20-%20Institutional%20 Shares%20(CRANX).pdf

2. Details of the Equity Portfolio

a. BBACAX fact sheet

http://www.bloomberg.com/quote/BBACAX:IND

b. Sector weightings from Aperio

GICS Sectors, %	Model Portfolio %	R3000 %
Consumer Discretionary	10.2	9.4
Consumer Staples	8.3	7.8
Energy	10.2	11.0
Financials	13.5	15.1
Health Care	12.0	12.8
Industrials	10.5	10.7
Information Technology	24.2	23.7
Materials	2.1	2.7
Telecommunication Services	4.1	3.1
Utilities	4.9	3.8

c. Screens and data elements from IW Financial

Auditing and Accounting ratings and flags evaluate companies' policies and procedures related to auditing and finance. Investors often look at a company's relationship with its auditing firm and the level of financial expertise on the board's audit committee. Data points in this category include disclosed percentage of audit fees, financial expert on audit committee, and restatement of earnings.

Board Accountability ratings and flags evaluate the level of responsibility and answerability of companies' boards. Although classified board elections may offer more continuity and smoother transitions, they can also discourage change and diminish accountability since directors are not subject to reelection every year. Also, companies with disclosed board responsibility for certain issues are considered more likely to establish policies and procedures addressing the issue. Data points in this category include organization of board, board responsibility for sustainability, and board responsibility for human rights.

Board Composition ratings and flags evaluate the makeup of companies' boards. Many investors consider the composition of a company's board to be an indicator of its effectiveness and how truly independent a board may be. Entrenched boards can be perceived as less independent. Data points for this category include tenured directors, absentee directors, and directors over the age of 70.

Board Independence ratings and flags evaluate the board's level of affiliation with the company. Board independence is considered by many investors to be a key to effective oversight of management. Data points in this category include the percentage of independent board members, the independent audit committee, and the independent compensation committee.

CEO Compensation ratings and flags evaluate how companies' top executives are incentivized. CEO compensation policies that reflect company performance and tie both short- and long-term compensation closely to shareholder returns suggest a strong, effective board. Data points in this category include CEO total compensation, CEO annual bonus, and incentive pay as a percentage of total.

Diversity ratings and flags evaluate the overall profile of companies on gender and minority issues. Elements include levels of disclosure, as well as performance in manager diversity and total workforce diversity. Data points in this category include senior management percentage of women, senior management percentage of minorities, and diversity disclosure.

Environmental Management ratings and flags evaluate the processes companies put in place to monitor and govern environmental issues affecting the company. These data elements look at the attributes of companies in these areas. Those interested in improving the environmental profile of corporations may use this information to determine which companies are paying public attention to a company in the form of disclosure and policies. Those evaluating overall governance and management may take this analysis as an indication of attentive management. Data points in this category include environmental disclosure, environmental policy, and ISO 14001 environmental management systems.

Environmental Performance ratings and flags evaluate certain aspects of corporate environmental performance and potential liability. Both total and per revenue ratings are available, allowing users to gauge overall impact and size-adjusted impact. Evaluation of data in this category can contribute to an overall sustainability evaluation of a company. Controversies sometimes exist over the health, safety, or convenience of consumers compared to certain environmental issues. Such controversies could include extra tamper-proof packaging on over-the-counter medications (arguably a waste of resources), or the decision to remain with coal to reduce the likelihood of a nuclear accident, or, in certain circumstances, policies to flush into wastewater federally controlled pharmaceutical substances to keep them out of recirculation and away from potential abusers. In addition, different environmental issues sometimes come into conflict with one another. The nuclear-versus-coal debate is an example of this. Nuclear power reduced toxic emissions as well as carbon dioxide emissions while having a host of its own environmental issues. In such instances, trade-offs take place as companies determine how to manage their environmental impacts and responsibilities to other stakeholders. Energy and water use may also be used to judge long-term exposure to rising energy costs. Data points in this category include toxic emissions, environmental fines, and energy use.

Human Rights ratings and flags evaluate the disclosure, policies, and exposure of companies to human rights issues and concerns. Advocates for human rights argue that the globalized economy and the size of many companies combine to make multinational corporations primary actors in many troubling human rights situations. The countries in which a company operates are evaluated when considering a company's exposure to human rights issues. Operations in countries of concern raise the potential for human rights issues becoming a problem. Some may view human rights as a government-to-government issue and consider companies small players in resolving these issues. In addition, companies are providing jobs and income to people who might otherwise have neither. On this basis, some investors are inclined to avoid using companies' international exposure as a proxy for human rights concerns. Data points in this category include ties to oppressive regimes, maquiladora operations, and human rights disclosure.

Recognition ratings and flags evaluate recognition that companies receive from "top 100" and "top 10"– type lists. Magazines and other groups often identify top company performers based on specific criteria that the particular magazine develops. These data elements tally the total number of such lists on which a company appears. Since each list has its own embedded methodology, exclusion from a specific list may not indicate poor performance of a company in a specific issue area. In addition, since the lists are so short, they represent only a small percentage of the companies on which other research is available. A pattern of recognition on such lists, however, may indicate a "consistent performer" within an issue area.

Data points in this category include diversity recognition and workplace recognition.

Sexual Orientation ratings and flags evaluate policies related to gender identity and sexual orientation. Proponents of extending benefits and protection from discrimination to gay, lesbian, bisexual, and transgender (GLBT) employees feel that such extension is a logical continuation of the civil rights movement. Proponents also argue that failure to adopt these policies restricts company access to talented people who can assist the company in meeting its business objectives. Opponents of GLBT-friendly policies and programs believe it legitimizes the GLBT lifestyles, which they view as immoral. These groups often characterize these programs as being antifamily and antimarriage. When evaluating this issue, investors may want to look at the financial implications of extending benefits programs, the reputational issues surrounding providing or withholding benefits from certain employees, and the potential for shareholder activism from proponents or opponents of a given company's policy. Data points in this category include nondiscrimination policy and same-sex benefits.

Workforce ratings and flags evaluate the relationship of a company to its workers and organized labor by looking at unionization rates, strikes, boycotts, disclosure, benefits, and EEOC findings. Whether from a rights perspective or a business continuity risk perspective, these ratings are a useful comparison for companies. Proponents of the union movement point to the contributions unions have made over time in protecting the health and welfare of major portions of the workforce. Many standards for work-life balance today were hard-fought victories for unions, including the standard 8-hour workday. Opponents of the union movement point to a virtually forced political association for workers who may have differing political views than a particular union. In addition, some argue that union rules and negotiations between unions and companies significantly reduce the flexibility of companies to address changing business environments. Data points in this category include strikes or labor actions, employee benefits, and EEOC disciplinary action.

3. Study guide: The powerpoint presentation for students, conferences

http://www.sealcovefinancial.com/articles/Investing%20to%20Impact%20Poverty%20UWBA%20Research%20Study%20Spring%202012.pdf

4. Glossary of Financial and Investment Terms

Alpha: A statistic measuring that portion of a stock, fund, or composite's total return attributable to specific or nonmarket risk. Alpha measures nonmarket return and indicates how much value has been added or lost. A positive Alpha indicates that the fund or composite has performed better than its Beta would predict (i.e., the manager has added value above the benchmark). A negative Alpha indicates a fund or composite that has underperformed given the composite's Beta.

Beta: Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. A Beta of 1 indicates that the security's price will move with the market. A Beta of less than 1 means the security will be less volatile than the market. A Beta greater than 1 indicates that the security's price will be more volatile than the market.

Duration: A measure of the sensitivity of the price (the value of the principal) of a fixed-income investment to a change in interest rates, expressed as a number of years.

Information Ratio: A ratio of portfolio returns above the returns of a benchmark (usually an index) to the volatility of those returns. The information ratio (IR) measures a portfolio manager's ability to generate excess returns relative to a benchmark, but it also attempts to identify the consistency of the investor. This ratio will identify if a manager has beaten the benchmark by a lot in a few months or a little every month. The higher the IR, the more consistent the manager, and consistency is an ideal trait.

R-Squared: A statistical measure that represents the percentage of a fund or security's movements that can be explained by movements in a benchmark index . For equities, the benchmark is the S&P 500. R-squared values range from 0 to 100. An R-squared of 100 means that all movements of a security are completely explained by movements in the index. A high R-squared (between 85 and 100) indicates that the fund's performance patterns have been in line with the index. A fund with a low R-squared (70 or less) doesn't act much like the index

Sharp Ratio: A ratio developed by Nobel laureate William F. Sharpe to measure risk-adjusted performance. The Sharpe ratio is calculated by subtracting the risk-free rate, such as that of the ten-year U.S. Treasury bond, from the rate of return for a portfolio and dividing the result by the standard deviation of the portfolio returns.

The Sharpe ratio tells us whether a portfolio's returns are to the result of smart investment decisions or a result of excess risk. This measurement is very useful because although one portfolio or fund can reap higher returns than its peers, it is only a good investment if those higher returns do not come with too much additional risk. The greater a portfolio's Sharpe ratio, the better its risk-adjusted performance has been. A negative Sharpe ratio indicates that a riskless asset would perform better than the security being analyzed.

Standard Deviation: 1. A measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. Standard deviation is calculated as the square root of variance. 2. In finance, standard deviation is applied to the annual rate of return of an investment to measure the investment's volatility. Standard deviation is also known as historical volatility and is used by investors as a gauge for the amount of expected volatility.

Tracking Error: The divergence between the price behavior of a position or a portfolio and the price behavior of a benchmark. This is often in the context of a hedge or mutual fund that did not work as effectively as intended, creating an unexpected profit or loss instead. Tracking errors are reported as a "standard deviation percentage" difference. This measure reports the difference between the return an investor receives and that of the benchmark he or she was attempting to imitate.

5. Author Biography and Acknowledgments

With nearly three decades of experience in developing and implementing strategies in the institutional investment industry, Lauryn Agnew serves as a resource to nonprofit organizations for investment consulting services and provides fiduciary education and trustee training for public fund and nonprofit board and committee members. She also offers strategic marketing analysis and recommendations to firms with specialized investment strategies through her company Seal Cove Financial (www.sealcovefinancial.com).

Her investment experience includes the sell-side (Smith Barney and Lehman Brothers in institutional equity sales on the trading desk), the buy-side (Harris Bretall and Wentworth Hauser and Violich as director of sales and marketing), and forming her own consulting firm as well as co-founding two investment management companies: a hedge fund and an asset-management firm.

Currently, Lauryn is a trustee on the Board of the San Mateo County Employees' Retirement Association (SamCERA), a defined benefit plan with $2.5 billion in assets. She is the chair of the investment committees at both the United Way of the Bay Area and the Girl Scouts of Northern California, and is a member of the finance committee of the Immaculate Conception Academy of San Francisco. Born in Wyoming, Lauryn grew up in Montana, earned her BA degree in Economics from Whitman College in Walla Walla, Washington, and her MBA in Finance from the University of Oregon. In the Bay Area, she is a member of the CFA Society of San Francisco and the Financial Women's Association of San Francisco.

This research would not have been possible without the help and support of many colleagues and associates. I am deeply grateful to the staff and leadership of the United Way of the Bay Area and the investment committee members who supported this project: Joan Braun, Anne Wilson, Eric McDonnell, Dottie Dutton, Frank Felicelli, Richard Del Monte, Mike Dorsey, Bob Thompson, and Nicole Portillo. The networking, background research, and introductions provided by Georgette Wong and Bert Feuss were invaluable. Encouragement, feedback, and technical information came from many, particularly Ben Thornley, David Erickson, Sarah Cleveland, Paul Herman, and Monica Pressley. My thanks also go to Paul Solli and Patrick Geddes of Aperio Group, Dan Porter of IW Financial, and Barbara Van Scoy of Community Capital Management for their insight and investment expertise.

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