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Community Development INVESTMENT REVIEW

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FEDERAL RESERVE BANK OF SAN FRANCISCO

CENTER FOR COMMUNITY DEVELOPMENT INVESTMENTS

Community Development INVESTMENT REVIEW

The Community Affairs Department of the Federal Reserve Bank of San Francisco created the Center for Community Development Investments to research and disseminate best practices in providing capital to low- and moderate-income communities. Part of this mission is accomplished by publishing the *Community Development Investment Review*. The *Review* brings together experts to write about various community development investment topics including:

Finance—new tools, techniques, or approaches that increase the volume, lower the cost, lower the risk, or in any way make investments in low-income communities more attractive;

Collaborations—ways in which different groups can pool resources and expertise to address the capital needs of low-income communities;

Public Policy—analysis of how government and public policy influence community development finance options;

Best Practices—showcase innovative projects, people, or institutions that are improving the investment opportunities in low-income areas.

The goal of the *Review* is to bridge the gap between theory and practice and to enlist as many viewpoints as possible—government, nonprofits, financial institutions, and beneficiaries. As a leading economist in the community development field describes it, the *Review* provides "ideas for people who get things done." For submission guidelines and themes of upcoming issues, visit our website: www.frbsf.org/cdinvestments. You may also contact David Erickson, Federal Reserve Bank of San Francisco, 101 Market Street, Mailstop 215, San Francisco, California, 94105-1530. (415) 974-3467, David.Erickson@sf.frb.org.

Center for Community Development Investments
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CENTER FOR COMMUNITY DEVELOPMENT INVESTMENTS

Table of Contents

Article

Commentary

Foreword

David J. Erickson
Federal Reserve Bank of San Francisco

October 2010

In the community development finance and impact investing worlds, there is both universal agreement for the need for better social outcome measurements and no consensus on how to do it. This issue of the *Review* is an attempt to gather in one place what we know, what we think the state of the art is, and how we might contribute to an ongoing process to establish a tool—or many tools—that help us measure the social benefit of impact and community investing.

Ben Thornley and Colby Dailey provide us with a comprehensive look at this issue in the lead article of this volume. They review the existing literature, highlight and explain leading tools and approaches, and provide a provocative new intellectual framework with which to analyze the issue. Thornley and Dailey caution us not to waste time on elusive "silver bullets." Instead, they suggest we create an environment—through new practices and policies—that encourage impact and community investors to collect and report social outcomes data. Even if existing data were more effectively reported, they argue, it would likely motivate clusters of investors to coalesce around certain social outcome reporting strategies. Alongside this incremental approach, however, Thornley and Dailey also propose more sweeping change from government. In particular, they suggest that changes to how the CDFI Fund requires community development financial institutions to collect and report social impact data, and how depository institutions covered by the Community Reinvestment Act (CRA) do the same, could create new standards overnight and drive catalytic improvements in social outcomes measurements.

The essays that follow Thornley and Dailey's article provide viewpoints on social outcomes measurements from a variety of perspectives—from government, philanthropy, investors, and fund managers.

Margot Brandenburg, a leader in the field of social outcomes measurements, makes the case for the chilling effects that may strangle an inchoate impact investing industry if we fail to solve the social outcomes measurement problem.

John Moon compares and contrasts the current stage of development for the impact investing field with early community development investing and questions whether changes to the CRA might help foster impact investing in a way that is similar to how it helped create the community development investing field. He argues that combining efforts from impact investing (e.g., the work of the Rockefeller Foundation with new measurement tools, taxonomy, and ratings) with developments in the community development investing sector (e.g,. Opportunity Finance Network's CARS rating system) would reinforce both sectors; he goes as far as to suggest that elements of one tool, such as the CRA, should be incorporated into the methodology of tools on the impact investing side and vice versa.

Arjan Schutte urges us to be practical as we pursue social outcomes measurements by focusing on: 1) measures within sectors – health care, alternative energy, financial eduction – instead of too-broad measures for all sectors; 2) outputs instead of a fuzzy understanding of impact; and 3) aligning a few measures or metrics that reinforce both operational objectives and financial incentives for investors and fund managers.

Penelope Douglas focuses her essay on a simple question: Who cares about social impact? The answer, according to her, are the millions of small depositors at banks, policy holders from insurance companies, and workers who contribute to pension funds. In each case, the community that provides the capital–depositors, policy holders, pensioners–give direction to their investor intermediaries on what values they want to promote with their money.

Allison Duncan and Georgette Wong emphasize the need for "leadership from all parts of the investment ecosystem, but most specifically asset owners, intermediaries, and businesses." They argue that if we can tell a better story about impact and demonstrate how it can reinforce (rather than detract from) financial return, then we have the opportunity to create radical change by attracting tens of trillions of dollars from global corporations, pension funds, and high net-worth individuals and families.

David Colby and Sarah Pickell provide the community development field with an example of how the Robert Wood Johnson Foundation measures its social impact–an activity that is not for the faint of heart since it makes failures, as well as successes, public. The commitment is worth it, they claim, since it brings to light the types of programs that make a real difference in people's lives.

Finally, Sameera Fazili weighs in on the question of how the government can help promote the field of social outcomes measurements. Although she concludes that too many competing policy, regulatory, and statutory issues make it unlikely that the federal government can lead the way to one standard, she does highlight the many ways the government can encourage this effort, including: 1) setting standards; 2) collecting and sharing data, and 3) providing a "Good Housekeeping Seal of Approval" for certain activities or institutions.

In the end, an effective way of measuring our social impact from institutional, retail, and government investments could change the way we look at both government and the market. A growing consciousness among consumers and investors about social and environmental issues is already changing the types of products and services that are available in the marketplace. Government, too, is seeking to change the ways it does business by providing more resources to programs that are proven to work and by directing funds away from programs that don't. Xavier De Souza Briggs, Deputy Director of the Office of Management and Budget, captured this idea at a recent Federal Reserve conference where he explained that leaders in the federal government are trying to change "the DNA of the federal government" so that it can take more risks and reward investments that yield better social outcomes. That change – both in the market and for government – requires better data on social impact.

David Erickson

Building Scale in Community Impact Investing through Nonfinancial Performance Measurement

Ben Thornley, *Pacific Community Ventures*
Colby Dailey, *NCB Capital Impact*[1]

Abstract

The measurement of nonfinancial performance is becoming increasingly important in the community impact investing industry, where individuals and institutions actively deploy capital in low-income domestic markets for both financial and social returns. Quality data ensure that the creation of jobs, construction of community facilities, financing of affordable housing, and other benefits that characterize the sector are delivered cost-effectively and transparently. This paper discusses the limited practice and future direction of nonfinancial performance measurement by revisiting four key questions:

1. Does nonfinancial performance measurement really matter for investors?
2. If it does matter, is nonfinancial performance measurement even possible?
3. If nonfinancial performance is possible to measure, what form should it take?
4. How will nonfinancial performance measurement increase community impact investing?

The paper examines the barriers to a more robust regime of nonfinancial performance measurement and posits both that innovation in the sector ought to be driven by the discrete but explicit needs and demands of investors, and that greater accountability has a special role to play in making disclosure more attractive. The report concludes that nonfinancial performance measurement directly informs the investment process and is essential to growing community impact investing because it provides latent sources of capital with market-level information on the tradeoffs between financial and social return. Although the industry is unlikely to discover the "silver bullet" of nonfinancial performance measurement in the near future, there is reason to be hopeful: measurement strategies can – and will – converge through private- and public-sector innovation.

1 The authors would like to acknowledge and thank all those who contributed to this article. We are grateful to David Erickson and Ian Galloway at the Federal Reserve Bank of San Francisco for their guidance and encouragement throughout the process, and for their support, without which the project would not have come to fruition. Likewise, Beth Sirull and Penelope Douglas at Pacific Community Ventures and Annie Donovan, Jim Gray and Rick Jacobus at NCB Capital Impact provided important insights as well as their blessing for our efforts. We are also indebted to the many practitioners who gave their time and expertise through interviews, survey responses and critical review, providing essential evidence and feedback, at the same time enlightening us on their inspiring work in community development. Special thanks to our contributing editor, Sarah Sullivant, University of California, Berkeley, Master of Public Policy candidate.

Part I: Introduction

Nonfinancial performance measurement has become a significant focus of the community impact investing industry, where individuals and institutions actively deploy capital in low-income domestic markets for both financial and nonfinancial return. Many industry stakeholders have a growing need for effective measurement -- the practice of evaluating and reporting the nonfinancial value that accrues to an investor from investments with a primary or ancillary social objective. Even so, others within the industry doubt that nonfinancial performance measurement is beneficial to investors at all. And there are those who simply find measuring nonfinancial performance difficult and frustrating because of bad data, poorly suited practices, or the volume and diversity of measurement tools that have emerged in recent years. Even as the industry continues to build much-needed infrastructure for evaluating nonfinancial returns on investment, our research suggests that, as a first step, understanding investor preferences and behaviors is critical to more effectively measuring performance.

This aritcle has three main sections. The first discusses the diversity of community impact investors and investments. The second highlights existing nonfinancial performance measurement tools and practices. It also describes the three key impediments to nonfinancial performance measurement: varied and ambiguous investor preferences; inadequate tools and practices; and a lack of accountability for nonfinancial return. The third section provides a framework for advancing nonfinancial performance measurement from an investor-centered perspective, asserting that investors' nonfinancial performance objectives ultimately inform, and are informed by, measurement tools and practices. This third section presents four questions that the field must consider in order to advance:

1. Does nonfinancial performance measurement really matter for investors?
2. If it does, is nonfinancial performance measurement even possible?
3. If it is possible, what form should it take?
4. How will nonfinancial performance measurement increase community impact investing?

Answering each of these questions in sequence, the third section introduces innovation and accountability as key factors that shape investor preferences for measuring and reporting nonfinancial return. We can derive additional insight not by classifying investors as "financial-first" or "impact-first" (the preferred binary approach in the research), but by placing them on two continua: one representing investors' willingness to pay for nonfinancial return, a unique indicator of the value an investor attributes to community impact; and one representing investors' willingness to disclose, which indicates the extent to which an investor is willing to be accountable for, and report, nonfinancial return. The article concludes by discussing opportunities for further research and market development.

Although "impact investing," broadly defined, has been coined to capture the diversity of capital actively seeking social and environmental benefits around the globe, the term "community impact investing" in this report refers only to low-income domestic markets, and only to investments targeting social returns, for example, in the areas of economic, workforce, and entrepreneurial development; housing; education; and health. The research focuses on the nonfinancial performance measurement tools and practices used by those investors hoping to at least recoup the principal sum of their investment. By extension, the research does not address evaluation activities at the purely philanthropic level.

Certainly there is a much larger universe of impact investing and nonfinancial performance measurement, including advanced efforts internationally and in sectors such as environmental sustainability and shareholder engagement. Although some of the nonfinancial performance measurement challenges in these areas mirror those we discuss in this report, there are distinctive qualities in U.S. community finance that call for a more narrow scope of research, not least in the type of investors in the sector and the regulatory environment in which they operate. Similarly, grant making in the community-based sector is an example of a more mature kind of social impact evaluation. But again, the conditions in which grant recipients and donors measure performance differ from those in community impact investing, where funding is directly contingent on both delivering and proving impact, and thus creating very clear financial incentives for those involved.

Research Evolution and Methodology

This project has required a change in tack multiple times, ultimately leading, in our opinion, to a compelling understanding of why nonfinancial performance measurement is important for scaling the sector. At the outset of the project, the goals were as follows: synthesize existing research on nonfinancial performance measurement, survey the landscape of performance measurement tools, and provide specific recommendations for advancing the field. We hoped to discover the specific metrics, the nonfinancial performance measurement tools, and the ideas with the best prospects for drawing additional capital into community impact investing – in other words, the "silver bullets." Although we met some of these initial goals, the direction of the project shifted. Rather than providing a framework for evaluating performance measurement tools, our research pointed to the need for a new emphasis on the behavior of investors, as informed in part by measurement tools and practices. Although the industry has put much thought into how to measure nonfinancial performance, the research illuminated prerequisite considerations including whether or not it should be done at all and, if so, why? By understanding the answers to these questions first, and approaching them through an investor-centered lens, the industry can address common barriers, better serve investors, and more successfully pursue effective nonfinancial performance measurement, ultimately leading to additional capital investment in the industry.

The research was conducted from December 2009 to August 2010 and included an extensive review of existing literature on impact investing and nonfinancial performance measurement. An important resource throughout the project has been the report "Investing for Social and Environment Impact", published by the Monitor Institute in 2009. This report outlines the current state of the broader impact investing industry and presents an important discussion on the steps necessary to build scale in the sector. Our research builds on a central thesis in the Monitor Institute report: that measurement of nonfinancial returns is one critical prerequisite for industry growth.[2]

The research involved surveys of and in-depth interviews with industry stakeholders including impact investors and performance measurement experts. This process, combined with the literature review, identified the barriers to nonfinancial performance measurement and the tools that exist to measure nonfinancial return. The interviews also provided important insights into the investor preferences at the center of our analysis. Finally, the research included a review of nonfinancial performance reporting and disclosure in annual reports of banks, nondepository financial institutions, community development financial institutions (CDFIs), and foundations making community impact investments.

Definitions

This paper discusses a number of concepts using the following terminology.

> **Community impact investing** involves actively placing capital in businesses, funds, and other opportunities that generate social good in low-income communities and return at least the principal to the investor.
>
> **Community impact investment industry**, also called "the industry," includes community impact investors, the vehicles by which investors make their investments, the underlying investments, and the measurement tools used to describe financial and nonfinancial return.
>
> **Community impact investors** are entities that actively deploy capital for social impact in low-income domestic markets – including in the areas of economic, workforce, and entrepreneurial development; housing; education; and health – regardless of whether the entity invests directly or through an intermediary.
>
> **Nonfinancial return** is the social benefit or other nonfinancial value that accrues to an investor from an investment.
>
> **Performance measurement tools**, for the purposes of this project, are tools designed to report on the nonfinancial return of investments.

2 Jessica Freireich and Katherine Fulton, "Investing for Social and Environmental Impact." (New York: Monitor Institute, January 2009).

Willingness to pay is a measure of the quantity of time, effort, investment earnings, or other resources that investors are willing to exchange for a preferred value of nonfinancial return.

Willingness to disclose is a measure of the quantity and quality of reporting of nonfinancial returns that investors are willing to provide to the stakeholders to which they are accountable.

Part II: The Community Impact Investing Industry

The community impact investing industry represents the combined efforts of a mixed group of individuals and institutions actively deploying capital in low-income domestic markets for financial and nonfinancial return. It is a cohesive industry, but one that is also diverse and multifaceted. It is subsidized in part by government regulations and programs, yet characterized by significant levels of innovation, particularly in the engineering and layering of products with disparate risk and return profiles to accommodate the very different financial and nonfinancial objectives of investors.

2.1 Community Impact Investors

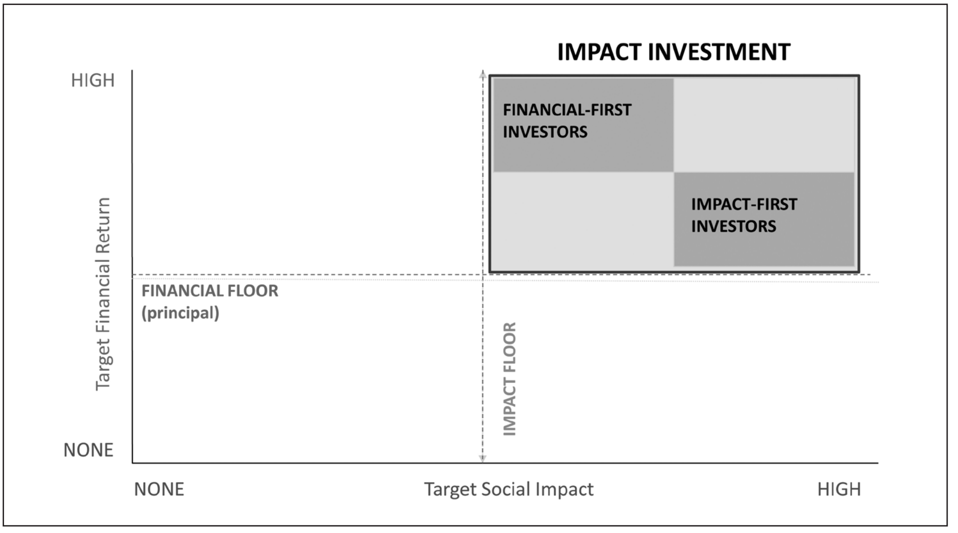
At the broadest level, the current literature categorizes community impact investors on the basis of their investment motivation: financial-first or impact-first.[3] Financial-first investors seek to optimize financial returns, with a minimum requirement for social or environmental impact. They are generally commercial investors searching for subsectors that offer a market rate of return but yield some social good.[4] Impact-first investors seek to optimize social or environmental performance while maintaining a floor for financial returns. They accept a range of returns, from principal-only to market rate, and seek social good as a primary objective.[5] Figure 1 illustrates this conception of the market.

3 Ibid, 32.

4 Steven Godeke and Raúl Pomares, "Solutions for Impact Investors: From Strategy to Implementation." (New York: Rockefeller Philanthropy Advisors, November 2009),11.

5 Ibid, 12.

Figure 1: Motivations of Impact Investors[6]



For many years, most investors in the community impact investing market have tended to be impact-first, including regulated special-purpose community development institutions, government, philanthropic foundations, banks motivated by regulatory mandate, and private individuals. Recent investors in the sector, who will likely come to provide a considerable proportion of new capital, tend to be financial-first, including nondepository institutions and investment funds.[7]

For the purposes of this research, community impact investors are entities that are actively deploying capital in low-income domestic markets for financial and nonfinancial return, regardless of whether they invest directly or through an intermediary. These investors fall into one of five structural categories: government, depository institutions, nondepository institutions, individuals, and foundations. We describe each category in turn.

Government

The public sector is a significant source of community impact investment at all levels. Federally, the CDFI Fund, within the U.S. Department of Treasury, channels financial support directly to the community development financial institutions (CDFIs) that register with the Fund. The Fund also administers the New Markets Tax Credit program, which we discuss in more detail under "depository financial institutions."

6 Freireich and Fulton, "Investing."
7 Ibid, 49.

The CDFI Fund was created by the 1994 Riegle Community Development and Regulatory Improvement Act to promote economic revitalization and community development through investment in and assistance to CDFIs. CDFIs are investment organizations whose primary mission is promoting community development in designated markets underserved by traditional capital. The CDFI Fund attracts an estimated $20 in non-federal government investments to the sector for every dollar provided to CDFIs.[8] Since 2003, the CDFI Fund has provided 436 financial assistance awards and a total of $346 million in financial assistance.[9]

Aside from the CDFI Fund, the federal government has invested in discrete sectors of the industry. For example, the government-sponsored enterprises Fannie Mae, Freddie Mac, and the Federal Home Loan Banks are active in real estate in low-income areas. The New Markets Venture Capital program, created in 2003 and administered by the Small Business Administration to promote economic development and job opportunities in low-income areas, helped to seed six new venture capital funds.[10] At the sub-federal level, significant investors and co-investors include economic development agencies, state housing finance agencies, and other public-sector entities.

The federal government also uses other subsidy sources, such as the Low Income Housing Tax Credit and block grants (including the Community Development Block Grant and HOME Investment Partnership), to entice more community impact investment in low- and moderate-income (LMI) areas.

Depository Institutions

Depository institutions, the backbone of the community impact investment sector, include community development banks and credit unions specifically created to work in markets underserved by traditional capital, as well as all others commercial banks and thrifts motivated by the Community Reinvestment Act (CRA). Depository institutions created to make community impact investments include the over 350 community development banks and over 290 community development credit unions registered with the CDFI Fund.[11]

Community development banks are FDIC-insured and federally regulated for-profit organizations with community board representation. Assets grew from $2.4 billion in 2001 to $13.7 billion in 2007.[12] These institutions act like traditional banks but operate in low-income target markets. Community development credit unions, which offer the same services as conventional credit unions, are member-owned nonprofit organizations regulated

8 Ben Bernanke, "By the Numbers: Data and Measurement in Community Economic Development," Community Development Investment Review 3 (2) (2007), 5.

9 CDFI Fund Award Database, www.cdfifund.gov. Financial assistance is just one of the forms of support provided by The CDFI Fund, which also awards grants for technical assistance, native initiatives, bank enterprise awards, and administers the New Markets Tax Credit program.

10 www.sba.gov. The SBA also has a Rural Business Investment Program, which catalyzed the creation of one additional venture capital company.

11 CDFI Data Project, Community Development Financial Institutions: Providing Capital, Building Communities, Creating Impact, 7th Ed. (Cleveland, OH: CDFI Data Project, 2007).

12 Ibid.

and typically insured by the National Credit Union Administration and/or by state agencies. They have grown rapidly in assets from $2.8 billion in 2001 to $7 billion in 2007.[13]

The primary motivation for traditional depository institutions to make community impact investments is the 1977 Community Reinvestment Act (CRA), which is intended to "encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations."[14] The CRA mandates that all depository institutions receiving FDIC insurance demonstrate a positive record for helping meet the credit needs of their entire community. According to CRA guidelines, an appropriate federal banking agency evaluates each depository institution periodically, taking its record into account in considering any application for new branch offices or mergers and acquisitions. Federal banking agencies involved in evaluation include the Federal Reserve System, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. Among the 998 institutions that reported CRA-motivated lending in 2007, 746 institutions extended $63.8 billion in community development loans.[15]

Depository financial institutions have also been bolstered by the federal government's New Markets Tax Credit (NMTC) program. The NMTC is administered by the CDFI Fund and allocates tax credits to certified community development entities (CDEs), which then provide the tax credits to private investors. CDEs must invest the entire private investments in low-income communities. Like CDFIs, many of which are also CDEs, CDEs are domestic corporations with a primary mission to serve or provide investment capital to low-income communities. The CDFI Fund has made 495 NMTC awards totaling $26 billion.[16] Although nondepository institutions typically have the largest number of deals, banks claim the largest proportion of the flow through credits.[17]

Nondepository Institutions

Nondepository institutions include those created specifically for the purpose of community investment–community development loan funds and community development venture capital funds registered with the CDFI Fund–as well as various pension funds, insurance companies, financial advisors, and investment funds investing for financial and nonfinancial returns.

13 Ibid.
14 Community Reinvestment Act, 12 U.S.C. § 2901 et seq. (1977).
15 www.ffiec.gov.
16 www.cdfifund.org.
17 Government Accountability Office, "Tax Policy: New Markets Tax Credit Appears to Increase Investment by Investors in Low-Income Communities, but Opportunities Exist to Better Monitor Compliance." Report no. GAO-07-296. (Washington, DC: GAO, January 2007). See also Lauren Lambie-Hanson, "Addressing the Prevalence of Real Estate Investments in the New Markets Tax Credit Program." (San Francisco: Federal Reserve Bank of San Francisco, Working Paper 2008-04).

Community development loan funds are primarily nonprofit organizations certified by the CDFI Fund that are created to lend in target markets to businesses, real estate and housing developers, nonprofit organizations, and individuals that are typically unable to obtain capital at favorable terms from traditional sources.[18] Assets in the sector, which includes more than 500 funds, have grown from $3.1 billion in 2001 to $4.6 billion in 2007.[19]

Community development venture capital funds, mostly organized as for-profit LLCs and limited partnerships, invest equity and equity-like debt in small companies with the potential for rapid growth in underserved communities. Assets in the sector, which includes around 70 funds, have grown markedly, from $300 million in 2001 to $2 billion in 2009.[20]

Some nondepository, non-CDFI institutions are also motivated to deploy capital to community impact investment opportunities by stringent mandates or the long shadow of regulation, although such oversight tends to be at a sub-federal level. For example, the trustees of a number of significant public pension funds require that the institutions make economically targeted investments with ancillary social objectives such as urban revitalization, supporting underserved markets, or economic development more broadly.[21] Another example is insurance companies doing business in California, which are subject to California Organized Investment Network (COIN) guidelines that require investment in community development. COIN, a collaborative effort between the California Department of Insurance, the insurance industry, and community affordable housing and economic development organizations, was established as an alternative to state legislation, much like the CRA, that would have required that insurance companies invest in underserved communities.[22]

Investing Foundations and Endowments

Philanthropic organizations, including corporate, community, religious, and especially private foundations, are some of the core capital providers to the community impact investment industry. For example, since 1986, the John D. and Catherine T. MacArthur Foundation alone has provided $250 million in grant and program-related investment (PRI) support to CDFIs.[23]

Private foundations tend to invest in community impact in one of two ways: through PRIs, which are investments with an explicit charitable purpose, generally made to advance a foundation's mission with the expectation of earning a highly concessionary financial return; and through mission-related investments (MRIs), which are market-driven investments that

18 Julia Sass Rubin, Financing Organizations with Debt and Equity: The Role of Community Development Loan and Venture Funds, Chapter 5. (New York: Russell Sage Foundation, 2007).

19 CDFI Data Project, Community Development Financial Institutions.

20 Kerwin Tesdell, "Community Development Venture Capital" (PowerPoint presentation, New School, New York, NY, April 1, 2010).

21 Lisa Hagerman, Gordan L. Clark, and Tessa Hebb, "Investment Intermediaries in Economic Development: Linking Public Pension Funds to Urban Revitalization," Community Development Investment Review 3 (1) (2007).

22 Information from www.impactcapital.net and www.insurance.ca.gov/0250-insurers/0700-coin/.

23 www.macfound.org. From the press release "CDFIs Receive Funding to Support Charter Schools," 2010.

typically originate from a foundation's endowment corpus and are expected to generate a market return but also to have social impact. From 1990 through 2008, foundations invested approximately $3.7 billion in 5,400 PRIs, albeit in a tremendous diversity of markets. In 2005 and 2006, the community impact investment sector accounted for at least 30 percent of PRI allocations.[24] The foundation category also includes "place-based" institutions such as colleges, hospitals, and other large pools of endowment capital with a clear interest in supporting local community infrastructure and development.

Individuals

Tens of thousands of individuals, including bank customers, mutual fund investors, and wealthy families, represent a critical source of capital to the community impact investment sector. For example, Trillium Asset Management, the $1 billion independent investment advisor devoted to sustainable investing for high net worth families, individuals, foundations, endowments, religious institutions, and other nonprofits, recently added a fifth CDFI to its list of community investment organizations available for client investment.[25] Individuals also account for about one-third of NMTC claimants[26] and over 40 percent of CDFI bank deposits.[27]

2.2 Community Impact Investments

This diversity of investors is matched only by the breadth of available community impact investments, which generally fall into three broad categories: investments by CDFIs and other special-purpose vehicles; investments using CDFIs as intermediaries; and investments in non-CDFI-driven opportunities. These categories of investments are not mutually exclusive, but rather overlap with each other, as illustrated in Figure 2. In fact, it is precisely the malleable nature of the market that spurs product innovation. Product innovation, which is key to attracting additional sources of capital, has typically been aimed at blending investments, particularly by leveraging public- and philanthropic-sector concessionary capital to better package, manage, and mitigate risk for other investors, including the most financially motivated ones.[28]

24 Foundation Center, The PRI Directory: Charitable Loans and Other Program-Related Investments by Foundations (New York: Author, 2009). Based on PRI transactions of $10,000 or more. The share to community impact investments is calculated from 2006–2007 data, using the investment categories of "economic/community development" and "housing and shelter."

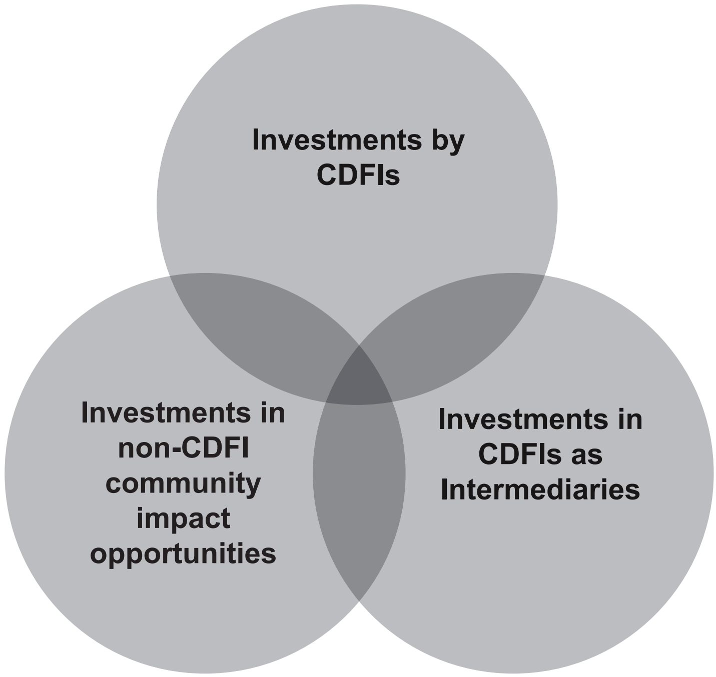
25 Trillium Asset Management, "Social Research & Advocacy: A Record of Accomplishment." Press release (Boston: Trillium, January 2007), available at http://trilliuminvest.com/pdf/tamc_2007_socialreport.pdf.

26 GAO, "Tax Policy."

27 Community Development Financial Institutions Fund, Three Year Trend Analysis of Community Investment Impact System Institutional Level Data, FY 2003-2005, Washington, DC, December 2007, in Paul Weech, "Observations on the Effects of the Financial Crisis and Economic Downturn on the Community Development Finance Sector." In The Economic Crisis and Community Development Finance: An Industry Assessment. Working Paper 2009-05 (San Francisco: Federal Reserve Bank of San Francisco, June 2009); 26-39.

28 Godeke and Pomares, "Solutions for Impact Investors."

Figure 2: Community Impact Investments



Investments by CDFIs

The investments by CDFIs and other special-purpose vehicles[29] include the loans, equity and debt-with-equity investments, guarantees, and loan sales that form the core of CDFI offerings.[30] Of the $17.6 billion in CDFI financing outstanding at the end of 2007 from banks, credit unions, and loan funds, 99 percent comprised loans.[31] The remainder primarily financed equity funds under the purview of banks, credit unions, and loan funds. Assets managed by the community development venture capital sector represent an additional $2 billion.[32] CDFIs have an explicit social mission, with objectives in community impact markets including economic development (such as job creation, business development, and commercial real estate development), affordable housing (including housing development and homeownership), and community development financial services (such as the provision of basic banking services to underserved communities and financial literacy training).[33]

29 "CDFIs and other special-purpose vehicles" is loosely defined to include CDFIs, CDEs, and any other entities required by regulation and supported by subsidy to make community impact investments. Opportunity Finance Network's Mark Pinsky calls this broader definition Community Development Investors – 'CDFIs, state housing finance agencies, bank community development lending teams or activities, as well as community development producers and asset managers such as CDCs, for-profit affordable housing developers, and others' (Pinsky 2009, 9).

30 CDFI Data Project, Community Development Financial Institutions.

31 Ibid.

32 Tesdell, "Community Development Venture Capital."

33 CDFI Fund, www.cdfifund.gov.

Investments using CDFIs as Intermediaries

CDFIs and other special-purpose vehicles play a critical role in the industry primarily as intermediaries and hubs for innovation. For investors far from the action who have little capacity for the difficult work of identifying and making investments with social impact, CDFIs are the logical path to implementation. For example, in November 2009, Goldman Sachs announced that it would invest $300 million through a combination of lending and philanthropic support to CDFIs in order to "increase the amount of growth capital available to small businesses in underserved communities and to expand the capacity of CDFIs to deliver enhanced technical assistance to small businesses."[34] CDFI capital under management comes from a diverse group of investors. For depository CDFIs, these include individuals (42 percent), private financial institutions including CRA-motivated banks (15 percent), and government (3 percent). For nondepository CDFIs, key capital providers include CRA-motivated banks (29 percent), government (16 percent), and philanthropic entities (12 percent).[35]

NMTCs also flow through CDFIs and other special-purpose vehicles into the hands of non-CDFI investors. The three largest NMTC claimants are banks and other regulated financial institutions (38 percent), individual investors (32 percent), and other corporate investors (18 percent).[36] When the U.S. Government Accountability Office (GAO) asked investors to specify which factors had a "very great" to "moderate effect" on their decision to invest in the NMTC program, responses included the wish to improve conditions in low-income communities (90.1 percent), obtain return on investment (82.1 percent), create or retain jobs (77.8 percent), obtain the tax credit (76.7 percent), expand lending relationships with special-purpose borrowers (52.0 percent), and comply with government regulations like the CRA (41.2 percent).[37]

Product innovation is critical to providing access to the community impact investing sector for many investors through CDFIs. Examples include:

- The first rated pool of securities backed by community development assets, known as CRF-17 (Community Reinvestment Fund USA Community Reinvestment Revenue Notes, Series 17): More than half of the investment classes in CRF-17 were rated AAA by Standard & Poor's (S&P), which used the Small Business Administration's Section 504 program as an alternative information source for assessing the quality of securities rather than CRF's more limited performance track record.[38]
- Tranched structures like the New York Acquisition Fund.[39] This fund leverages

34 Goldman Sachs, "Goldman Sachs Launches 10,000 Small Businesses Initiative." Press Release (New York: Goldman Sachs, November 17, 2009)
35 Weech, "Observations", 28.
36 GAO, "Tax Policy."
37 Ibid.
38 M. Swack and N. Giszpenc, eds., "Financial Innovations Roundtable: Developing Practical Solutions to Scale up Integrated Community Development Strategies." Report no. 8. (Durham: Carsey Institute, University of New Hamphire, 2009), 13.
39 www.nycacquisitionfund.com.

government grants and subsidized foundation capital to fund a $230 million pool for bridging the period between property acquisition and construction closing in order to finance the construction and preservation of affordable housing. The fund's originating CDFI lenders include the Corporation for Supportive Housing, the Enterprise Community Loan Fund, the Low Income Investment Fund, and the Local Initiatives Support Corporation.[40]

- Intermediaries that aggregate capital and provide due diligence to CDFIs. Examples of these intermediaries include the Calvert Foundation, Trillium Asset Management, and Domini Social Investments. For example, in September 2009, the Calvert Community Note had invested approximately half of $170 million in domestic loans and companies, partly on behalf of individuals with as little as $1,000 to invest.[41]

Investments in Non-CDFI-Driven Opportunities

The community impact investing industry becomes more difficult to demarcate once it moves beyond the territory of the more visible CDFI sector. It is perhaps easiest to describe the diversity of investor activities and product preferences anecdotally, as in the following examples:

- The economically targeted investments of public employee pension funds we discussed earlier were estimated in 2007 to include $11 billion of commitments to urban revitalization, emerging domestic markets, or economic development more broadly.[42] Many of these funds are invested outside the realm of CDFIs.
- More than $133 million invested since 1992 by angel investors, professional venture capitalists, foundations, and family offices in more than 200 companies and small funds addressing social and environmental issues, facilitated by Investor's Circle.[43]
- Targeted private-sector socially responsible investment activities include the JP Morgan Urban Renaissance Property Fund, which has $175 million of capital for investing in the "development and redevelopment of real estate projects in market rate, affordable and workforce housing, retail, mixed-use development, hospitality and other real estate sectors in Urban Renaissance Markets."[44]
- $10 billion has been invested with venture capital companies that target minority-owned businesses, of which 51 percent is attributable to pension funds.[45]

40 Antony Bugg-Levine and John Goldstein, "Impact Investing: Harnessing Capital Markets to Solve Problems at Scale," Community Development Investment Review 5 (2) (2009), 37.

41 Calvert Community Note, Social impact report 2009.

42 Hagerman, Clark and Hebb, "Investment Intermediaries in Economic Development."

43 www.investorscircle.net.

44 Tracy Pun Palandijan, "Investing for Impact: Case Studies Across Asset Classes." (Parthenon Group, Bridges Ventures, and Global Impact Investing Network, March 5, 2010), 23.

45 Data from both the National Association of Investment Companies website, www.naicvc.com, and T. Bates and W. Bradford, "Traits and Performance of the Minority Venture-Capital Industry." Annals of the American Academy of Political and Social Science 613 (1) (2007): 95–107.

Financial Performance in Community Impact Investing

Perhaps the only characteristic that truly unites investors and investments in the community impact investment sector is their extraordinary variety. In no small measure, the growth of the industry depends on this very diversity, by bringing together investors that need exposure to the same asset class and engineering products that allow some to satisfy social priorities and others to meet financial obligations. The Monitor Institute calls these initiatives "Yin-Yang" deals, blending different types of capital with different requirements and motivations.[46] In short, the very premise of community impact investing – the structural bias and explicit preference of many investors for social impact over and above investment performance – makes any attempt to describe financial return not only fraught with difficulty, but in many respects irrelevant. Community impact investing reflects the "blended value" proposition that Jed Emerson promotes:

> All organizations, whether for-profit or not, create value that consists of economic, social and environmental value components – and that investors (whether market-rate, charitable or some mix of the two) simultaneously generate all three forms of value through providing capital to organizations. The outcome of all this activity is value creation and that value is itself non-divisible and, therefore, a blend of these three elements.[47]

Financial return often appears to be just one variable that an investor can readily and knowingly trade for another, such as mitigated risks or enhanced social impact. This is true for many community impact investors, but certainly not for all. A growing number, including those with the largest pools of nondepository capital who are now starting to enter the sector, insist that social impact can, and must, be additive, requiring no diminishment of financial returns.

There is reason to believe that this is possible. For example, in the private equity sector, the products in which nondepository institutions have invested appear to have delivered a market rate of return. This includes private equity funds investing in minority-owned businesses, which have produced financial returns that are comparable to or higher than those of conventional venture capital funds, and at least two larger funds that target job creation in low-income communities.[48] One of these, the Bay Area Equity Fund, had raised over $86 million for its second investment partnership as of July 2010; another, Pacific Community Ventures, is expected to raise an equally ambitious fourth fund shortly, primarily on the strength of the performance of its third.[49] In real estate, the return on economically targeted investments of the New York City Employees Retirement System was reported to be 6.5 percent for the three years preceding June 2008, versus 5.48 percent for the benchmark

46 Freireich and Fulton, "Investing." 32.
47 www.blendedvalue.org.
48 Bates and Bradford, "Traits and Performance."
49 From the Securities and Exchange Commission filing for DBL Equity Fund - BAEF II, available at: http://sec.gov/Archives/edgar/data/1453736/000095010310002078/xslFormDX01/primary_doc.xml.

Lehman Aggregate.[50] In fact, in the context of pension funds investing in urban revitalization, nonfinancial return is often referred to as "extra-financial" return.[51]

Not surprisingly, many community impact investments generally underperform traditional financial markets. In equity, the typical community development venture capital fund has been characterized as delivering returns in the range of 5–10 percent as compared to 20–30 percent for the SBA's Small Business Investment Company program, which supports a traditional venture capital model.[52] In the area of debt investments, two of the only mutual funds pooling CRA-qualified loans – one managed by Access Capital Strategies, a part of RBC Global Asset Management, and another by the Florida-based investment company Community Capital Management – have underperformed the market benchmark by 0.37 percent and 1.05 percent, respectively, over the past five years.[53] At an institutional level, CDFI Fund awardees tend to have fewer total assets, higher loan delinquency and charge-off rates, and lower returns on assets than their non-CDFI contemporaries.[54] In recent years, CDFI banks and thrifts have been hit hard by the recession. The ratio of median noncurrent loans to total loans deteriorated from 2.2 percent at the end of 2007 to 3.82 percent at the end of 2009, whereas the all-banks median ratio was 1.76 percent. Median return on assets at CDFI banks fell from 0.71 percent in 2007 to 0.02 percent in 2009, below the all-bank median of 0.47.[55]

Although the role and importance of traditional market-rate returns in community impact investing may be heightened by the entry of more financially motivated investors, the unique social benefits that community impact investments provide will continue to justify below-market returns for the many investors who highly value nonfinancial performance.

Part III: Measuring Nonfinancial Return on Investment

There is a wide variety of types of investors and vehicles in which they invest.[56] In keeping with such diversity, community impact investors demonstrate nonfinancial returns using a wide range of tools and practices to measure performance. As more investors provide capital to the industry, the notion of nonfinancial performance measurement becomes more important, even as barriers emerge to prevent effective implementation. The following section

50 Comments from New York Comptroller William Thompson Jr., the sole trustee of the New York City Employees Retirement System, in Benjamin Sarlin, "Comptroller: Pension Funds Can be Social Change Engines." Sun, June 11, 2008.

51 Lisa Hagerman, "More Than a Profit? Measuring the Social and Green Outcomes of Urban Investments," 4. (Cambridge, MA: Harvard Law School Labor & Worklife Program, July 2007).

52 Senator John Kerry, The American Community Renewal and New Markets Empowerment Act, S2779, 106th Congress, Congressional Record 146 (2000): S5684.

53 www.Morningstar.com.

54 S. Rajan, "Measuring the Financial Soundness of CDFIs." (Cambridge, MA: Kennedy School Policy Analysis, April 2001).

55 National Community Investment Fund, The CDFI Banking Sector: 2009 Annual Financial and Social Performance. (Chicago: NCIF, 2009). 32

56 Hagerman, "More than a Profit?", 11.

discusses the methods by which we can evaluate nonfinancial return and the impediments to the development of more effective approaches. The section surveys a number of existing tools and discusses current innovations in the field.

3.1 Nonfinancial Performance Measurement Practices

The growth of community impact investing to include more institutional investors such as public-sector pension funds, foundations, banks, insurance companies, and faith-based organizations has greatly increased the potential for social benefit.[57] However, only through performance measurement can we understand the true value of the social impact, and thus its benefit.[58] The entry of more investors with more investment capital into the field has emphasized the importance of understanding nonfinancial performance. High-quality measurement and reporting provide investors with the data they need to make informed choices.[59]

Investors who measure nonfinancial returns use a variety of methods and metrics that are typically aligned with the asset class in which they invest. The amount of detail in reports of nonfinancial returns also varies substantially. For example, the $170 billion California Public Employees Retirement System (CalPERS) uses the third-party services of Pacific Community Ventures (PCV) to measure the "ancillary" benefits of its $1 billion California Initiative, a private equity fund targeting underserved markets in California. PCV uses detailed, customized metrics including jobs created, employee benefits, low-income workers supported, and female and minority ownership and management at the underlying companies in which CalPERS invests.[60] CDFIs, on the other hand, have converged on the more limited, standardized metrics required by the CDFI Fund's Community Investment Impact System (CIIS), including jobs created and affordable housing units or community facilities financed and created.

In order to further illuminate nonfinancial performance measurement and reporting practices, our research included a review of a number of annual reports published by community impact investors including banks, foundations, CDFIs, and nondepository institutions; these reports indicated significant differences and clear trends across investor categories. Some highlights and general observations are listed below:

- Few impact investors surveyed include nonfinancial performance in annual reports. Any measures reported are usually published separately or only on the investor's website.
- CDFIs reported nonfinancial performance in the greatest depth, with measures of job

57 Bugg-Levine and Goldstein, "Impact Investing."

58 Lisa Hagerman and Janneke Ratcliffe, "Increasing Access to Capital: Could Better Measurement of Social and Environmental Outcomes Entice More Institutional Investment Capital into Underserved Communities?" Community Development Investment Review 5 (2) (2009), 44.

59 Hagerman, "More than a Profit?," 34.

60 CalPERS, 2010 Annual Report.

creation, housing units and commercial/facilities spaces financed, number of individuals served, and minority group representation, as illustrated by the Louisville Community Development Bancorp (see Figure 3).

Figure 3: Louisville Community Development Bancorp

Reporting of Nonfinancial Performance

The Bancorp gauges success with five simple measurable objectives:

1. *Stimulate small business expansion. Measured by the number of commercial loans made, businesses assisted, jobs created, and technical assistance customers served.*
2. *Increase home ownership. Measured by the number of families owning homes as a result of Bancorp activities.*
3. *Improving the quality and value of real estate. Measured by the number of acquisition/rehab loans, housing units developed, and home or commercial site improvement loans.*
4. *Increase the quantity of available goods and services. Measured by the number of loans to firms providing needed goods and services in the neighborhoods served.*
5. *Connect residents to career path employment. Measured by the number of jobs created.*

- Banks, in particular, use nonfinancial performance primarily as a marketing and branding tool in annual reports, featuring stories and photographs but no accompanying analysis. All of the major banks we sampled published separate corporate citizenship/CSR reports or disclosed CRA lending volume on websites. For example, Wells Fargo reports that "affordable housing projects in communities across the country often face challenges. In Portland, Oregon, a nonprofit group, Cedar Sinai, struggled to gather the financing needed to buy and preserve a 235-unit senior housing complex. Wells Fargo helped meet the need. We structured a multimillion-dollar financing plan for the nonprofit to buy and preserve the building and protect residents from potential rent hikes."[61]
- Foundations and pension funds were the least likely to publicly report nonfinancial performance in their annual reports, and they reported it in the form of anecdotal success stories. Of the annual reports we surveyed, the Calvert Foundation was the only foundation that reported impact data, stating that its investments have resulted in 2,397 homes built or rehabilitated.[62]
- Investment firms generally highlight nonfinancial performance by describing screening and selection processes and the characteristics of underlying portfolio companies, but not outputs or outcomes.

61 Wells Fargo 2009 Annual Report, available at https://www.wellsfargo.com/downloads/pdf/invest_relations/wf2009annualreport.pdf .

62 Calvert Foundation, 2008 Annual Report, available at www.calvertfoundation.org/downloads/annual_reports/2008%20Annual%20Report.pdf.

Perhaps most surprising was that the majority of annual reports failed to discuss nonfinancial performance at all. As a proxy for nonfinancial return, many community impact investors report the total dollars invested and/or the number of loans provided to the industry as a way of expressing impact, and many annual reports categorize investments by sector such as housing, workforce development, and education. The small minority of investors that report outputs used metrics for jobs created or maintained and housing units created. Anecdotal reporting was by far the most prevalent type of nonfinancial performance disclosure, although the level of robustness anecdotal reporting provides when measuring impact remains unclear. As one interview subject related, "On the spectrum from social to financial return, it was clear that, on the social side, we were using stories and anecdotes and there was no way to differentiate between orders of magnitude."

In addition to reviewing annual reports, we surveyed investors regarding nonfinancial performance measurement. The survey demonstrated that, where investors do measure nonfinancial return, they use a wide range of methods and metrics, including jobs created, the gender and race of executives and company owners, company and worker location in an LMI community, housing units and other projects financed, child care and education slots created, environmental risks and benefits mitigated or supported, regulatory compliance, employee training and education, job quality, and sustainability practices. Interestingly, survey respondents indicated that a key driver of nonfinancial performance measurement is accountability, saying in effect that they measure and report nonfinancial returns because they are generally answerable for their performance. Most survey respondents were explicitly accountable to stakeholders, including clients (investors), sponsoring program officers, social investment committees, governing boards, senior executives, the community at large, funders, employees, government, and shareholders.

What is high-quality performance measurement and reporting?

The community impact investment industry can look to the traditional finance sector for examples of best reporting practices. The Global Investment Performance Standards (GIPS), which underpin the traditional investment management industry, specify that quality measurement and disclosure at least include the following: [63]

- Longitudinal data to reflect performance over time;
- Comparison to a baseline and external benchmarks;
- Independent third-party verification;
- Disclosure of calculation methodologies and definitions; and
- Timely release and update of information

63 The GIPS standards are a set of standardized, industry-wide ethical principles that provide investment firms with guidance on how to calculate and report their investment results to prospective clients, administered by the CFA Institute (available at www.gipsstandards.org).

Table 1: Financial and Nonfinancial Disclosure

	Financial performance disclosure by traditional investment industry (GIPS Disclosure Requirements)	Nonfinancial performance disclosure by community impact investment industry
Time period	Longitudinal data	Usually point-in-time (i.e., one period)
Benchmarking	Financial performance data is benchmarked against the market and peers	No benchmarking, often because no benchmark exists
Verification	Third-party verification of all data	Only some investors use third-party verification
Methodology	Disclosure of calculation methodologies and definition	Rarely disclosed
Reporting	Timely release and update of information	When required by stakeholders (e.g., CDFI Fund), but typically not publicly, and not voluntarily

As Table 1 shows, the community impact investing industry has a long way to go toward meeting the standards of quality reporting in traditional markets. At least one sector of the investment industry – corporate governance and shareholder engagement – already measures nonfinancial performance robustly, and this practice of measurement has catalyzed significant growth. In corporate governance, global standards and the market for active share ownership emerged primarily as a result of data and performance measurement originating from proxy-service firms including the Investor Responsibility Research Center and Institutional Shareholder Services, governance ratings firms such as GovernanceMetrics International and Davis Global Advisors, and the coverage of corporate governance issues by the major credit agencies including S&P, Moody's, and Fitch.[64] Moreover, the International Corporate Governance Network (ICGN)[65] recently approved a set of best practices for disclosure of nonfinancial performance. Intended to further raise standards of corporate governance globally, the best practices specify that reporting ought to be:

- Genuinely informative and forward-looking when this will enhance understanding;
- Material, relevant, and timely;

64 James Hawley and Andrew Williams, "Shifting Ground: Emerging Global Corporate-Governance Standards and the Rise of Fiduciary Capitalism," Environment and Planning A 37 (11) (2005): 1995-2013.

65 ICGN was created in 1995 as a global membership organization of primarily institutional investors to raise corporate governance standards worldwide. ICGN's members represent funds under management of around $9.5 trillion (www.icgn.org).

- Accessible and appropriately integrated with other information that enables investors to gain a whole picture of a company;
- Linked to strategy and easily comparable using key performance indicators;
- Presented using objective or evidence-based metrics; and
- Strengthened where possible by independent assurance.

3.2 Nonfinancial Performance Measurement Tools

This section provides an overview of eight tools for measuring impact. Each has a significant presence in the industry, whether by creating a template and providing a platform for community impact investors to self-report nonfinancial returns, or by providing third-party nonfinancial performance measurement advisory services and reporting. We selected these tools specifically because of their applicability to the scope of our research – namely, that community impact investors use them concretely. Further, these tools aggregate or publish data that investors and/or other stakeholders can use to benchmark nonfinancial performance. The list is not exhaustive, but it is substantially representative of the actual measurement of nonfinancial performance in community impact investing. The tools provide varying levels of customization and service, at different costs to investors.

This overview consists of a short description of each tool's development and methodology, the metrics it reports, how users collect and report the data, and the categories of investors using the tool. We compiled the information for these profiles using each tool's respective website and literature, stakeholder interviews, and the report "Catalog of Approaches to Impact Measurement – Assessing Social Impact in Private Ventures" by Sara Olsen and Brett Galimidi.[66] Table 2 below summarizes the key characteristics of the tools.

66 Sara Olsen and Brett Galimidi, "Catalog of Approaches to Impact Measurement – Assessing Social Impact in Private Ventures." (San Francisco: Social Venture Technology Group, May 2008).

Table 2: Nonfinancial Performance Measurement Tools

Measurement tool	Cost to end user	Metrics	Benchmarking	Output	Data collection	End user
B Impact Rating System	No Cost	Standardized	Underlying investments (registered B corporations) are benchmarked against each other	Financial and nonfinancial performance attributable to B corporations	Data are collected in survey form and analyzed by a third party	Banks and venture capital funds (currently)
CDFI Data Project	No Cost	Standardized	Reports overall impact of CDFIs – no attributable benchmarking	Aggregated data include financial and nonfinancial performance	Data are collected in survey form and analyzed by a third party	CDFIs and investors in CDFIs
Community Investment Impact System	No Cost	Standardized	Benchmarked against other CDFIs and CDEs	Infrequent release of aggregate financial and nonfinancial data	Data are collected in survey form and analyzed by a third party	CDFI Fund
Global Impact Investing Rating System	Low Cost	Somewhat customized	Rated investments are benchmarked against each other	Publicly available rating, attributable to underlying investment. Nonfinancial data only	Data are collected in survey form and analyzed by a third party	Pilot investors (current)
Pacific Community Ventures	High Cost	Customized	Benchmarking of performance to broader market trends, absent the investor's intervention	Detailed nonfinancial performance report to client	Third-party collection of survey responses. Third-party analysis	Institutional private equity investors, foundations
NCIF Social Performance Metrics	No Cost	Standardized	Benchmarking across "CDBIs". Performance is attributable	Public reporting. Detailed summary and individual reports.	Third-party collection of public data and survey responses. Third-party analysis	Investors in depository CDFIs
CDFI Assessment and Ratings System (CARS)	Moderate Cost	Highly customized nonfinancial metrics	Benchmarked against other CARS-rated organizations	Detailed reports available by subscription to investors. Financial and nonfinancial performance	Third-party data collection, via survey and audit. Third-party analysis	Investors in CDFIs
CDVCA Measuring Impacts Toolkit	No Cost	Standardized	Reports overall impact of CDVC funds with no attributable information	Aggregated financial and nonfinancial data	Data collection by survey. Third-party analysis	Community development venture capitalists

B Impact Rating System

The B Impact Ratings System (BIRS) is a free, online tool from B Lab that measures businesses' impact on employees, the environment, community, suppliers, and consumers, as well as their accountability to stakeholders. B Lab developed BIRS in 2007 with the feedback of entrepreneurs, investors, and educators. The metrics and weightings in BIRS are governed by the Standards Advisory Council, an independent body of nine experts in social and environmental sustainability.[67] BIRS is intended to help B Lab to certify B corporations (corporations that are committed to meeting BIRS standards) and investors to select high-impact investments, policymakers to drive tax or procurement decisions, and business associations to educate their members.[68] The report rates a company according to those standards and how well it institutionalizes employee, community, and environmental welfare in its governance and structure. The assessment is customized for the company undertaking it. According to B Lab representatives, investors currently using BIRS to evaluate nonfinancial impact include banks and venture capital funds, but they expect CDFIs, pension funds, microfinance institutions, and equity funds outside the United States to begin using it soon.

CDFI Data Project

The CDFI Data Project (CDP) is a collaborative effort by key trade associations including the Opportunity Finance Network, the Community Development Venture Capital Alliance, and the Association for Enterprise Opportunity to collect and analyze CDFI data that include the sector's community impacts.[69] The goal of the CDP is to ensure access and use of data by CDFIs and CDFI investors to improve practice and attract resources to the CDFI field. The data set includes approximately 100 data points on operations, financing, capitalization, and impact, focusing primarily on operational data but including demographic and socioeconomic borrower and investment recipient information.[70] Although 508 CDFIs reported to the CDP in 2007, the data were disclosed only at the aggregate and sub-sectoral level, with no attributable institution-level information.[71] CDFIs can elect to have the CDP list their names alongside their data , but at present none of the CDFIs take advantage of the opportunity, at least in the reporting of community impacts.

Community Investment Impact System (CIIS)

The CDFI Fund uses the Community Investment Impact System (CIIS) to track and measure the financial and nonfinancial impact of CDFIs and CDEs receiving CDFI Fund awards. The CIIS, designed to be the primary data source for the CDFI industry, compiles data for two reports: an institutional-level report (ILR) and the industry's only standardized transaction-level report (TLR).[72] The TLR includes nearly 200 data points covering each individual loan and investment, although submitting many of those data points is optional. The ILR captures organizational data that include background information on the submitting institutions. Any certified CDFI can voluntarily submit a TLR. The CDFI Fund currently

67 http://www.bcorporation.net.
68 Ibid.
69 Opportunity Finance Network website, http://www.opportunityfinance.net/.
70 Ibid.
71 CDFI Data Project, Community Development Financial Institutions.
72 Heidi Kaplan, "First Mover: The CDFI Fund's CIIS Database Holds Promise to Create Substantial Data Repository for Community Development Investments," Community Development Investment Review 3 (2) (2007), 51.

shares CIIS data with two additional federal agencies and two private parties conducting contracted services for the CDFI Fund. CIIS community impact metrics include jobs created, affordable housing units supported, and the capacity of community facilities financed.[73]

Global Impact Investing Rating System (GIIRS)

The Global Impact Investing Rating System (GIIRS) is currently under development by B Lab in partnership with a steering committee of the Global Impact Investing Network.[74] The GIIRS is intended to "assess the social and environmental impact (but not the financial performance) of companies and funds using a ratings methodology analogous to Morningstar investment ratings or S&P credit risk ratings."[75] Although this system looks at global impact investing, we included it in the tools survey because of its direct implications for domestic community impact investing. It is intended for use by both institutional investors and investment intermediaries to evaluate, screen, manage, and communicate the social impact of their investments. According to the GIIRS website, the GIIRS includes surveys that differ by geography, size of company, and industry. Each survey includes approximately 160 questions divided into five categories: leadership, employees, environment, community, and products & services. The GIIRS will make its ratings system (including all survey questions and the weightings methodology) transparent to the public.[76]

Pacific Community Ventures

Pacific Community Ventures (PCV), provides an impact measurement tool and third-party advisory service designed to provide detailed employment and job quality data for each portfolio company to which financially driven private equity investors are exposed, aggregated at the portfolio level. The analysis is implemented as an in-depth annual or biannual report based on social metrics that the investor and PCV agree to collect. PCV provides a detailed report on nonfinancial performance to clients, including most notably the California Public Employees Retirement System (CalPERS) and foundations including the Northwest Area Foundation and the Annie E. Casey Foundation. PCV uses metrics including jobs created, employee benefits, low-income workers supported, and female and minority ownership and management at underlying portfolio companies. PCV's report to CalPERS is publicly available and includes detailed methodological information. The report also benchmarks CalPERS' performance to the appropriate state and national workforce data.

73 www.cdfifund.gov.

74 Founding GIIN members include the Acumen Fund, The Annie E. Casey Foundation, The Bill and Melinda Gates Foundation, Calvert Foundation, Capricorn Investment Group, Citigroup, Deutsche Bank, Equilibrium Capital, Generation Investment Management, Gray Ghost Ventures, IGNIA, J.P. Morgan, Lundin for Africa, Lunt Family Office (Armonia), Omidyar Network, Prudential, The Rockefeller Foundation, Root Capital, Shorebank/NCIF, Trans-Century, Triodos Investment Management, and Wolfensohn & Company (www.globalimpactinvestingnetwork.org, Accessed May 1, 2010).

75 www. giirs.org, Accessed May 1, 2010

76 Ibid.

NCIF Social Performance Metrics

The National Community Investment Fund (NCIF) developed its Social Performance Metrics tool to measure the social impact of banks and thrifts working in underserved populations, also called community development banking institutions (CDBIs).[77] The tool uses a number of industry-specific metrics, including publicly available census data, branch location data, and mortgage loan data. For example, NCIF's development lending intensity metric assesses the percentage of an institution's home loan originations and purchases that are located in LMI census tracts. The goal is to provide investors with information that will help them make targeted investments based on geographic need. Accompanying these metrics is a qualitative survey that probes CDBI service area, mission, and partners. The database tool is located on the NCIF website and is available to the public.[78]

CDFI Assessment and Rating System (CARS)

The CDFI Assessment and Rating System (CARS), a project of the Opportunity Finance Network, is designed as a comprehensive third-party assessment of CDFI loan fund nonfinancial and financial performance. The purpose of CARS is to "increase the amount of capital available [CDFIs] for community development purposes and to promote CDFI performance as a primary criterion determining the flow of capital through these institutions to economically disadvantaged people." CARS provides ratings for both financial strength and impact performance based on a five-year track record. Information is collected through on-site examinations that include in-depth interviews with management and board members, analysis of financial and programmatic information, and thorough review of loan files and risk management systems. Although high-performing CDFIs often publish their rating score, the comprehensive results of their analyses are available only by subscription for CDFI investors. Approximately 55 CDFIs receive a CARS rating, and 35 impact investors have subscribed to the CARS reports.[79]

Community Development Venture Capital Alliance's Measuring Impacts Toolkit (MIT)

The Community Development Venture Capital Alliance's Measuring Impacts Toolkit (MIT) is specifically targeted to venture capital impact investors. The MIT is a Microsoft Excel–based survey with more than 70 questions at its core. Additional survey modules collect data on benefits, wealth building, and training, and include over an additional 100 data points according to company type. The core social impact data, collected for each company in a fund's portfolio, cover three major impact areas: employment, wages and career ladders, and benefits. The module survey data cover impacts on community and the

77 Saurabh Narain and Joseph Schmidt, "NCIF Social Performance Metrics: Increasing the Flow of Investments in Distressed Neighborhoods through Community Development Banking Institutions," Community Development Investment Review 5 (2) (2009), 65.

78 www.ncif.org.

79 www.carsratingsystem.net/ratings, accessed May 1, 2010.

environment.[80] The data are reported in the aggregate in order to preserve the portfolio companies' anonymity; however, the MIT is designed to be an inexpensive "off-the-shelf" product that individual venture capital funds can purchase. There is no provision for entering individual funds' data into a central system for sector-wide reporting.

3.3 Barriers to Measuring Nonfinancial Performance

The tools and practices we highlighted above represent a sample of current efforts, but it remains the case that very few investors either rigorously measure or report nonfinancial returns. This phenomenon is not new to the industry and has been the subject of discussion among stakeholders for some time. The following section highlights the barriers to a more robust regime of industry-wide performance measurement, first briefly describing nine distinct barriers identified in the literature and then explaining how the nine distill into three major impediments to nonfinancial performance measurement that the industry must confront.

Nine Barriers Evident in the Literature

The literature enumerates nine specific barriers to industry-wide nonfinancial performance measurement. These barriers underscore the extent to which diversity characterizes the community impact investing industry. A brief description of each of the nine barriers follows.

1. *Diversity of investor preferences and nonfinancial objectives.*
   Each investor – be it a bank, a public sector pension fund, an insurance company, a foundation, or a faith-based organization – places a different value on nonfinancial return.[81] Further, their investments in different sectors reflect their various missions and visions (such as investments in job creation, support for emerging domestic markets, or construction of affordable housing). These differences are a significant barrier to any attempt to distill the interests, preferences, and aspirations of all investors into a single industry-wide nonfinancial performance measurement practice.

2. *Diversity of measurement methods.*
   The increasing number of measurement tools points to a state of uncoordinated innovation in which duplicate activity and confusion over language result in inefficiency.[82] Investors feel overwhelmed or misinformed by the lack of consensus around what constitutes a robust or actionable methodology.

80 CDVCA Measuring Impacts Toolkit v1.1, 2005.
81 Hagerman and Ratcliffe, "Increasing Access to Capital," 48.
82 Kaplan, "First Mover," 58.

3. *Diversity of products and underlying investments.*
   The variety of products through which to invest – from loan pools to private equity funds – and investment targets – from women- or minority-owned businesses to affordable housing – presents significantly different challenges to measuring performance.[83]

4. *High cost and low capacity.*
   Nonfinancial performance measurement can be costly, time consuming, and peripheral to the core competencies and capacities of investors.[84]

5. *Lack of data or information about the provider.*
   There is no consistent and detailed information on the performance of community impact investing intermediaries, particularly outside of the CDFI Fund, which also lacks transparency.[85]

6. *Lack of data or information about the product.*
   Data on underlying community impact investments and the markets in which capital is being deployed are often fragmented, nonstandardized, and not widely accessible.[86]

7. *Lack of infrastructure.*
   The network of markets, accountants, auditors, and standards needed to track and verify nonfinancial performance as rigorously as financial performance lags; social program evaluation lacks maturity; and the current approaches to nonfinancial measurement continue to be people- and expertise-dependent, lacking the systemization to ensure basic levels of reproducible data, data integrity, and comparability.[87]

8. *Insufficient demand.*
   For many investors, the costs outweigh the benefits of both measuring and reporting nonfinancial returns. According to Lisa Hagerman and Janneke Ratcliffe, demand for nonfinancial performance measurement is something of a "chicken and egg dilemma," in that "improved and more widespread social impact measurement will only develop to the extent investors require it, [even as] investor interest hinges on developing a more clearly defined and measurable investment theme."[88]

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83 Hagerman, "More than a Profit?," 5.
84 Hagerman and Ratcliffe, "Increasing Access to Capital," 49.
85 Kaplan, "First Mover," 56. See also, Ellen Seidman, "Bridging the Information Gap between Capital Markets Investors and CDFIs," Community Development Investment Review 2 (2) (2006).
86 Cynthia Gair, "SROI Act II: A Call to Action for Next Generation SROI." (San Francisco: REDF, October 2009).
87 Freireich and Fulton, "Investing." See also, Gair, "SROI Act II."
88 Hagerman and Ratcliffe, "Increasing Access to Capital," 57.

9. *Business practices.*
   Stakeholders often view the information necessary for measuring nonfinancial performance as private or proprietary.[89] Although legal or technical solutions may address privacy concerns, some investors are suspicious of providing data to external parties that they are unaccustomed to sharing.[90]

Three Key Barriers in Practice

These nine barriers create problems of varying magnitude for investors; some are merely nuisances, whereas others create a very real sense of frustration and hopelessness. Stakeholder interviews suggest that, in practice, they distill into three key impediments: diverse and ambiguous investor preferences; broadly inadequate tools and practices; and a lack of accountability for nonfinancial return.

Diverse and Ambiguous Investor Preferences

As we have discussed throughout this paper, the nonfinancial goals and objectives of investors differ substantially.[91] Investor preferences that are driven by different structural, operational, cultural, and stakeholder priorities result in very different demands for nonfinancial performance measurement and reporting. The problem of ambiguity stems from the difficulty of expressing or quantifying the value that investors assign to nonfinancial returns, either because the value is so intrinsic that it may be difficult to fully articulate, or simply because the value is intangible or immeasurable. Although any attempt to fully describe the nonfinancial preferences of investors is inherently speculative, objectives beyond measurable outputs (such as jobs created or properties financed) include brand differentiation, a desire to influence the behavior of the market, addressing perceived market failures, efforts to achieve political or values-oriented goals, and the need to satisfy regulatory requirements. Diversity and ambiguity in investor nonfinancial objectives inherently limit the pool of prospective investors who might use any single measurement tool or practice.

Inadequate Tools and Practices

Numerous structural and operational limitations render nonfinancial performance measurement tools and practices inadequate for many investors. These limitations might include insufficient or unverifiable data, infrastructure and methodological barriers, inefficient or unsuitable processes and systems, and unaffordable third-party or even off-the-shelf tools.[92] Unless investors believe that a tool or practice is truly cost-effective – cost measured in time and resources, and effectiveness measured in the quality, relevance, and value of the informa-

89 Ibid, 61.
90 Glenn Yago, Betsy Zeidman, and Jill Manning, "Hunting for Data Sources: How Improving Data Can Increase Capital for Emerging Domestic Markets," Community Development Investment Review 3 (2) (2007).
91 Hagerman, "More than a Profit?," 5.
92 Kaplan, "First Mover, 58"; see also Hagerman, "More than a Profit," 30; and Hagerman and Ratcliffe, "Increasing Access to Capital," 61.

tion it provides to key stakeholders – they are unlikely to devote whatever effort is necessary to supporting nonfinancial performance measurement. The fact remains that measuring nonfinancial performance is simply very difficult. Although tools and practices will become more suitable and effective over time, it is likely to take many years to address underlying impediments.

Lack of Accountability for Nonfinancial Return

Most community impact investors are simply not required to report nonfinancial returns, reducing the likelihood that they will devote time and resources to measurement, and reducing their demand for tools and practices. For example, even the largest investor in the sector – the CDFI Fund – requires that CDFIs report data only when receiving technical or financial assistance or NMTC allocations. Even then, CDFIs must respond only to a relatively narrow set of eight community impact survey questions. In any one year, just one-fifth of CDFIs are mandated to report to the CDFI Fund.[93] Although CDFIs more willingly provide data to industry-driven initiatives like the CDFI Data Project, the data are presented only in the aggregate and are not attributable.

The lack of accountability for nonfinancial returns, and by extension the lack of demand for nonfinancial performance measurement, means that few industry resources are deployed to develop and enhance practices, with one or two notable exceptions. When accountability is clear, and creates an incentive to measure nonfinancial performance, measurement and reporting are likely to be prevalent and robust. For example, because CalPERS demands a detailed annual report on the "auxiliary benefits" of the California Initiative, the 30 funds that manage money for the program (and the 200 companies in which they invest) are subject to some of the most rigorous nonfinancial reporting requirements in the sector. Similarly, the impact investors that responded to the more detailed survey we discussed above have two things in common: they report nonfinancial returns, and they do so in part because they believe that they are accountable for the nonfinancial returns that they measure.

Other factors contribute to limited accountability. First, accountability is itself a function of other variables. According to one interview subject, "accountability is a good framework for discussing what metrics are needed, but having the right balance of metrics is important because having too many, or a system that is too complicated, reduces accuracy and cooperation." In other words, investors will be more accountable for nonfinancial performance if the tools that they use to measure performance are well suited to the task. Second, accountability differs significantly by investor type, particularly for those deploying their own capital (foundations and individuals) and those entrusted with investing the money of others (depository and nondepository institutions and government). Finally, many investors also consider accountability to be a risk. For example, reactions to the possibility of linking CDFI Fund data to individual entities have been mixed. As one interview subject confirmed, "Some see it as an opportunity, others as a threat. How do we present the information objectively without offending key stakeholders?"

93 Kaplan, "First Mover," 53.

Moving Forward

The community impact investing industry is substantial. It includes a large number of investors making thousands of diverse investments, valued at tens of billions of dollars, for both financial and nonfinancial return. Yet a surprising number of community impact investors either do not measure nonfinancial performance robustly or do not disclose their findings. In order to advance the field, the industry first needs to revisit why nonfinancial performance measurement is critical to scaling the sector. In order to make a case for nonfinancial performance measurement, we need an understanding of investor preferences that addresses the barriers we described above and considers ways to motivate industry-wide action.

Part IV: The Case for Nonfinancial Performance Measurement

Effective nonfinancial performance measurement is a key component of the impact investing industry's growth and, as such, an important part of unlocking an estimated $500 billion in potential capital.[94] Tools and practices continue to surface, and because investors have very different preferences for nonfinancial return and nonfinancial performance measurement, innovation will likely consist of a continued proliferation of approaches. No matter how diffuse the way forward, however, it is essential to make a stronger and more cohesive case for nonfinancial performance measurement in general.

Our research underscores four key questions that investors and industry stakeholders are currently asking, and need to address, in order to advance the field.

1. Does nonfinancial performance measurement really matter for investors?
2. If it does matter, is nonfinancial performance measurement even possible?
3. If nonfinancial performance is possible to measure, what form should it take?
4. How will nonfinancial performance measurement increase community impact investing?

This section discusses each question in order, highlighting investor behavior as a determinant of the field's development and discussing the role of two crucial means of effecting change: innovation and accountability. The section also introduces a new method for characterizing investors, asserting that each has a willingness to pay for nonfinancial performance, which is an indication of the value an investor assigns to nonfinancial return, and a willingness to disclose, which is an indication of the extent to which an investor is accountable for, and reports, community impacts. Insight into these two characteristics provides a number of important general observations about the role and future direction of nonfinancial performance measurement.

94 The Monitor Institute estimates that impact investing more broadly – the active deployment of capital for social and environmental impact, domestically and internationally – could grow in the next 5–10 years to represent 1 percent of investment assets under management or $500 billion (Freireich and Fulton, "Investing"), 57.

4.1 Does Nonfinancial Performance Measurement Really Matter for Investors?

A number of industry stakeholders remain agnostic about nonfinancial performance measurement. Federal Reserve Chairman Ben Bernanke, however, is not one of them. Speaking in 2006 about the importance of data and measurement in community finance, Bernanke argued that "It is difficult to overstate the importance of adequate and accurate information for attracting capital."[95] Nancy Andrews, President and CEO of the Low Income Investment Fund (LIIF), recently expressed a similar sentiment, writing that "impact analysis is at least as important as financial performance."[96] However, for every Chairman Bernanke and Nancy Andrews, there is an impact investor asking the questions: "What do investors want? Is it really social return, or is social return just icing on the cake?"; and "Do investors value data or measures of social impact, or just a seal of approval?"[97] Even as the prevalence of measurement as a subject of discourse underscores that nonfinancial performance measurement does matter – together with some unprecedented investments in innovation[98] – we must ask the question: "but why?" The answer is that nonfinancial performance measurement informs investor behavior and is instrumental to determining an investor's willingness to pay for nonfinancial return.

Willingness to Pay

Willingness to pay is a concept that provides additional insight into investors' nonfinancial performance objectives. It describes the quantity of time, effort, investment earnings, or other resources that investors are willing to exchange for a preferred value of nonfinancial return. It is similar to the current method for describing investors as either financial-first or impact-first, but it places them on a continuum instead of placing them in the two categories.[99] By locating investors on a continuum, willingness to pay better accommodates the tremendous diversity of investor nonfinancial objectives. It recognizes that an investor's preferences for nonfinancial return are discrete, and that no single investor is likely to have the exact same objectives. The magnitude of an investor's willingness to pay is informed by a wide range of inputs including strategic, operational, and cultural priorities; outside stakeholders; and the availability of actionable data. Only the investor can truly know the "value" that it places on nonfinancial return, or the "price" that it is willing to pay for that value. Table 3 illustrates some examples of these values and prices.

95 Bernanke, "By the Numbers," 3.

96 Nancy Andrews and Christopher Kramer, "Coming Out as a Human Capitalist: Community Development at the Nexus of People and Place," Community Development Investment Review 5 (3) (2009), 63.

97 Two direct quotes from interview subjects.

98 The Rockefeller Foundation, the United States Agency for International Development, Prudential Financial, and Deloitte have partnered with the nonprofit B Lab to provide $6.5 million to support the development and use of GIIRS. B Lab, "Impact Investing Partnership with USAID, Rockefeller Foundation, Deloitte, and Prudential Financial to Support Entrepreneurs in the Developing World." Press release. (Berwyn, PA: B Lab, April 26, 2010).

99 Freireich and Fulton, "Investing."32

Table 3: The "Value" and "Price" of Nonfinancial Return

The 'value' of non-financial return	The 'price' investors might be willing to pay for non-financial return
• Satisfying mandated or explicit client nonfinancial objectives • Meeting regulatory requirements • Explicit nonfinancial outcomes (e.g. jobs created, affordable housing units financed) • Brand differentiation • Influencing the behavior of the market • Political and values-oriented benefits • Economic efficiency gains (i.e. redressing market failures or producing public goods)	• Time and cost of providing evidence against discrete objectives • Management/investment effort required to earn mandated nonfinancial return • Transparency and accountability • Effort demonstrating compliance to regulator • Below-market returns in target markets • Resources devoted to building and maintaining brand • Higher operating or transaction costs • The costs of participating in and leading dialogue

The idea of willingness to pay is born of current industry practices and is not intended to be controversial. On the contrary, the values and prices in Table 3 are plainly visible. A pension or investment fund must satisfy mandated client objectives and must provide evidence that it has done so. The CRA requires banks to invest in low-income communities and to demonstrate this compliance to regulators. CDFIs and other mission-driven investors have an interest in explicit community impacts, and they typically carry higher operating and transaction costs to meet these objectives.[100] Private foundations are eager to "move the needle," influencing the behavior of markets, and will consider the costs of participating in and leading industry dialogue as one component of the expense of doing so.

Investors that place the highest value on nonfinancial return will be willing to pay the most for it. For example, a foundation interested in creating housing opportunities may provide capital to an affordable property developer through a program-related loan with a concessionary cost of borrowing. Conversely, a CRA-regulated bank investing in the same affordable housing project is more likely to provide financing at a price closer to the market rate of return. Although existing literature may refer to these investors as impact first and financial first, respectively, we can also envision them at different points on the willingness to pay continuum. The New York Acquisition Fund is an example of an investment that used capital from investors with a high willingness to pay to secure financing from investors with a low or no willingness to pay. The Fund leveraged an $8 million, 0 percent interest rate loan from the public sector as a first loss fund, and $32 million in below-market foundation

100 The efficiency ratio for CDFI banks ended 2008 at 83.58 percent compared to the "all bank" median efficiency ratio of 70.91 percent. National Community Investment Fund, The CDFI Banking Sector: 2009 Annual Financial and Social Performance. (Chicago: NCIF, 2009).

PRIs as a second loss fund, to attract more than $200 million in senior debt authority from conventional lenders.[101]

For most community impact investors – including public agencies, foundations, and CRA-motivated banks – some value of nonfinancial return supplants financial return. In other words, the price these investors are willing to pay includes a tradeoff between financial and nonfinancial return. However, for other investors required to maximize financial return at all times, the value of nonfinancial return may be purely additive, creating a "total return" that is more valuable than a market return. These investors will be unwilling to pay for nonfinancial return in the form of below-market financial earnings. Such investors include the public pension funds making economically-targeted investments under the auspices of a fiduciary duty to current and future retirees.

Nonfinancial Performance Measurement and Willingness to Pay

Nonfinancial performance measurement is critical because, simply put, willingness to pay is partly determined by the quality of the information that investors use to make decisions about financial and nonfinancial tradeoffs.[102] In other words, investor behavior is shaped by the very practice of nonfinancial performance measurement. For one community development venture capital fund, CEI Ventures, nonfinancial performance measurement is said to affect "fund formation, investment decision making, the provision and allocation of resources, [and] messaging, and is vital to achieving goals."[103]

To be sure, the question "does nonfinancial performance measurement really matter for investors?" is somewhat extraneous. Investors must decide independently if nonfinancial performance matters. To the extent that it does, high-quality data and information are essential.

4.2 Can Nonfinancial Performance Actually Be Measured?

There is still the problem of seemingly intractable barriers to measurement, including the diversity and ambiguity of investor preferences, insufficient infrastructure, and poor data. In practice, however, nonfinancial performance is already being measured, is already informing investor behavior, and will continue to improve as a result of innovation.

Addressing the Barriers to Nonfinancial Performance Measurement through Innovation

Despite the challenges, there are steps that industry and government can take, and are already taking, to ensure that the measurement of nonfinancial returns becomes more effective and widespread. The efforts of the recently created Global Impact Investing Network

101 Lisa Richter, "California Community Development Finance Meeting: Strategies to Respond to the Economic Crisis, Issues Backgrounder." San Francisco: Federal Reserve Bank of San Francisco Working Paper, November 2009).

102 Hagerman, "More than a Profit?," 33.

103 Dawn Marie Estlow Stillings, "Measuring the Social & Environmental Impacts of Community Based Investing – More than Data Points: A Comprehensive Process and its Challenges." (Presentation to Public Pension Funds & Urban Revitalization Initiative, December 11, 2007.)

(GIIN) and the closely related Investment Reporting and Investment Standards (IRIS) are especially notable. Founded in 2007 by the Rockefeller Foundation and a group of other impact investors,[104] the 40-member GIIN specifies its purpose as "identifying and addressing the systemic barriers that hinder the impact investing industry's efficiency and effectiveness."[105] The IRIS project, which evolved out of original efforts begun by the Rockefeller Foundation, the Acumen Fund, and B Lab, and is now is administered by GIIN, represents the network's efforts to create a taxonomy for impact investing and a framework for reporting and evaluating nonfinancial returns. IRIS hopes to provide a standard set of metrics that can be compared and rated across the universe of impact investments.[106]

GIIN is also behind the development of the GIIRS rating system, which advocates believe through its very existence will create more demand for nonfinancial performance measurement. As a supporter of GIIRS, stated:

> *As we provide tools with more credibility, that are more cost effective and transparent, it will become more difficult for investors to willfully not use social performance tools. At the moment, with the industry more fragmented, it is easier to understand why investors do not measure social performance. But there will be fewer opportunities not to hold yourself accountable moving forward.*[107]

A more targeted, discrete form of industry-driven innovation is the Center for Financial Services Innovation's (CFSI) work on a new scorecard measuring the "customer impact" of financial services companies targeting the "underbanked." CFSI will ultimately promote the scorecard to other investors in need of similar nonfinancial performance information.[108] Moreover, many of the tools we profile in this report are improving daily. PVC is a case in point, working to expand its third-party impact evaluation services to a number of new categories of socially oriented venture capital funds, as well as to other asset classes.

SVT Group, a widely used social evaluator, addresses diverse investor preferences by approaching nonfinancial return as a management discipline. Rather than setting out to measure specific units of return, SVT Group helps stakeholders evaluate the process by which they achieve impact. In this vein, SVT Group sees nonfinancial performance not as the endgame of, but rather the path to, community impact. SVT Group has developed the SROI Toolkit to help investors and corporations manage impact rather than simply measure it.

Other industry actors address the barriers through policy innovation. For example,

104 Founding GIIN members include the Acumen Fund, The Annie E. Casey Foundation, The Bill and Melinda Gates Foundation, Calvert Foundation, Capricorn Investment Group, Citigroup, Deutsche Bank, Equilibrium Capital, Generation Investment Management, Gray Ghost Ventures, IGNIA, J.P. Morgan, Lundin for Africa, Lunt Family Office (Armonia), Omidyar Network, Prudential, The Rockefeller Foundation, Root Capital, Shorebank/NCIF, Trans-Century, Triodos Investment Management, and Wolfensohn & Company (www.globalimpactinvestingnetwork.org).

105 www.globalimpactinvestingnetwork.com.

106 www.iris-standards.org.

107 Direct quote from interview

108 Interview with Arjan Shutte, CORE Innovation Capital, April 5, 2010.

Opportunity Finance Network has advocated for the creation of an "innovation bank" within the CDFI Fund, a research and development program that could serve as a logical source of funding for improving nonfinancial performance measurement.[109] B Lab's ongoing work to promote state laws accommodating B corporations is also likely to improve the nonfinancial performance measurement practices of the investors that deploy capital to these new types of companies, in so doing generating and incentivizing additional accountability.[110]

The federal government also plays a role in promoting more effective measurement through innovation. The CDFI Fund regularly updates the CIIS system technology and user accessibility.[111] In addition, on May 14, 2010, the CDFI Fund invited public comment on continuing reforms, including in the areas of minimizing the cost and burden of data collection and CDFI/CDE compliance, and the quality, utility, and clarity of the information being collected.[112] Further, the CRA has recently come under review by its regulators, which include the Federal Reserve's Board of Governors, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, and could be subject to changes that affect how depository agencies make community impact investments and how they measure and report on those investments.[113]

Because of innovations like these, nonfinancial performance measurement is informing investor behavior like never before. The NCIF Social Performance Metrics framework is one tool that has helped drive investment to high-performing community impact investors. According to NCIF, several community development banking institutions are already demonstrating their "willingness to report more impact information to investors since these institutions have received greater funding from the socially responsible investor community."[114] Bank of America Merrill Lynch, which measures the nonfinancial performance of its Capital Access Funds (CAF), a private equity fund-of-funds investing in underserved markets for clients including CalPERS, the California State Teachers' Retirement System, and the New York State Common Retirement Fund, states that "CAF reviews its efficiency in realizing social impact on an ongoing basis to ensure that its investing efforts identify the impact areas that are of most interest to CAF as it considers fund investments." And Federal Reserve Chairman Ben Bernanke recently highlighted the CARS rating system as potentially having "the double benefit of attracting more funds into community development and helping to ensure that those funds are effectively used."[115]

109 Opportunity Finance Network, "Top Policy Recommendations for Opportunity Finance," www.nextamericanopportunity.org/toprecommendations.

110 B Lab, Certified B Corporation Public Policy homepage, www.bcorporation.net/publicpolicy.

111 Kaplan, "First Mover," 54.

112 www.cdfifund.gov.

113 Board of Governors of the Federal Reserve, "Agencies Announce Public Hearings on Community Reinvestment Act Regulations." Press release (June 17, 2010), available at www.federalreserve.gov/newsevents/press/bcreg/20100617b.htm.

114 Narain and Schmidt, "NCIF," 73.

115 Bernanke, "By the Numbers," 4.

Although barriers, including poor data and measurement infrastructure, will continue to hamper the quality of nonfinancial performance measurement tools, they do not render the practice altogether futile. On the contrary, investors are already leveraging business-relevant insights from nonfinancial performance measurement, and will benefit from further innovation.

4.3 What Form Should Nonfinancial Performance Measurement Take?

Innovation occurs at all levels and comes from a wide range of stakeholders--from the practices of a single community impact investor to the broad initiatives implemented voluntarily by industry or imposed by regulation. Not surprisingly, this diffuse form of innovation reflects the diverse nature of the community impact investment industry and the variety of investor preferences for nonfinancial return.

Put another way, there is a proliferation of nonfinancial performance measurement tools and practices precisely because investors demand it. It is not surprising that existing tools are insufficient, but this is not an insurmountable obstacle. For now, however, there is no silver bullet for measuring nonfinancial performance – no single metric, tool, or practice that suits every investor. Such a silver bullet is unlikely to emerge in the immediate future, but even so, the way to pursue greater standardization is to accommodate the ways in which investors express their preferences for community impact.

The Investor-Centered Perspective

Investors drive demand for nonfinancial performance measurement as both the consumers and the producers of community impact data. Innovation in nonfinancial performance measurement is therefore likely to be more catalytic if it reflects and responds to investors' varied nonfinancial objectives, structures, and investment strategies. Innovation that focuses first on the development of tools and practices, and expects investors to adjust their behavior accordingly, is likely to see greater resistance.

Although an investor-centered perspective implies that innovation will be diffuse and that the silver bullet is more likely to be an arsenal of measurement tools, in practice the metrics that investors use and report on are often similar within a sector. Categories of investors that invest in particular asset classes, that are subject to similar regulatory requirements, or that have similar nonfinancial objectives tend to coalesce around the same data. For example, most banks subject to the CRA, including three-quarters of those we reviewed for this project, report the volume of loans provided to low-income communities in annual reports. CDFI loan fund disclosures highlight the type and quantity of community facilities financed or constructed. And for investors working to create "quality jobs," health and retirement benefits for the workers their investments support are important measures of success.

The development of IRIS demonstrates both the overall complexity of the community impact investing sector and the progress toward a more consolidated system of nonfinancial performance evaluation. The first version of the IRIS taxonomy includes more than

170 operational, financial, and descriptor metrics applicable to all investors. Yet once IRIS drills down to the investors' area of interest, the number of metrics falls substantially – for example, to 38 in community development finance, 43 in education, and 40 in healthcare.[116]

Shared investor preferences and a strong understanding of willingness to pay are important anchors for the future development of nonfinancial performance measurement. However, the investor-centered approach is also tied directly to accountability. To the extent that investors measure and report nonfinancial performance, they often do so because they are required to. As one interview subject conjectured: "It is perfectly reasonable behavior of organizations not to want to collect more information. If they collect it, what will they get? What's the upside?" And as another confirmed, "if the requirement to provide data is voluntary, the tool or practice will have limited value."

Willingness to Disclose

Willingness to disclose is another concept that we can use to characterize investors, one that relates directly to accountability. Willingness to disclose is a measure of the quantity and quality of nonfinancial return reporting that investors are willing to provide to the stakeholders to which they are accountable. The magnitude of an investor's willingness to disclose is shaped both by internal preferences – the value that an investor places on information and transparency – and by external forces, including the extent to which stakeholders request or demand disclosure. A larger magnitude implies a higher quality of reporting that is likely to be more akin to practices in the traditional investment management industry we discussed earlier, where measurement is longitudinal, performance is benchmarked and independently verified, and evaluation methodology is transparent.

Insights into Nonfinancial Performance Measurement Using Willingness to Disclose and Willingness to Pay

As with willingness to pay, willingness to disclose falls on a continuum. By plotting the willingness to pay and willingness to disclose continua simultaneously, our research provides some important general insights into the drivers of innovation and accountability and, by extension, the direction that nonfinancial performance measurement will likely take.

For the purposes of this research, we consider the locations on the two continua of seven categories of community impact investors:

- ***CDFI recipients of CDFI Fund assistance*** are mission-driven and created for the explicit purpose of investing in underserved communities. CDFIs have a high willingness to pay for nonfinancial return and, because they receive government funds and must report to the CIIS, they have a high willingness to disclose nonfinancial return to the stakeholders to which they are accountable.

116 www.iris-standards.org. The first version includes 105 operational metrics, 36 financial metrics, and 33 descriptor metrics.

- ***Most other CDFIs*** also have a high willingness to pay but, without the requirement to report data to the CDFI Fund, lack the incentive to measure nonfinancial performance and have a lower willingness to disclose. Only one-fifth of CDFIs report to the CDFI fund and even fewer – 56 out of more than 1,000 – work with the industry-driven initiative providing the most attributable community impact information, CARS.[117]
- ***Private foundations*** are also mission-driven and, like CDFIs, are mandated to invest in a way that advances that mission, at least through program-related investments, where they typically accept a concessionary rate of financial return. Thus they have a high willingness to pay. But as our review of annual reports revealed, private foundations are among the least likely to measure nonfinancial return or to report other than anecdotally. Most private foundations therefore have a low willingness to disclose.
- ***Socially motivated individuals*** often have strong personal preferences for community impact and are accountable to no other third parties for any financial or other tradeoffs. At the same time, as with foundations, individuals have no stakeholders to whom they are required to report or disclose nonfinancial returns. Individuals therefore have a high willingness to pay but a low willingness to disclose.
- ***Banks subject to the CRA*** have a regulatory incentive to invest in low-income communities but are increasingly reluctant to trade financial return for the social impact resulting from CRA-compliant investments.[118] Banks have a low willingness to pay and, despite some reporting of anecdotal and demographic evidence, have demonstrated a relatively low willingness to disclose.
- ***Most nondepository financial institutions*** have a fiduciary duty to prioritize financial return and thus little appetite for "paying" for nonfinancial return. They also have little accountability for nonfinancial return and rarely measure or disclose that return, unless they are especially self-motivated or are required to by mandate or regulation. These investors have both a low willingness to pay and a low willingness to disclose.
- ***Mandate-driven nondepository financial institutions*** that are required to invest in community impacts share the same fiduciary duty to clients and the same reluctance to overtly sacrifice financial return for social return as ordinary nondepository institutions, demonstrating a low willingness to pay. Yet because they are accountable to the mandate, they are often obliged to evaluate and report performance, resulting in a higher willingness to disclose. Investors in this category include CalPERS and the BAML Capital Access Funds, which we discussed earlier.

117 CARS Rating System, www.carsratingsystem.net/ratings/ratedCDFIs.asp, accessed August 2010
118 Weech, "Observations," 31.

Figure 4: Continua of Investor Preferences

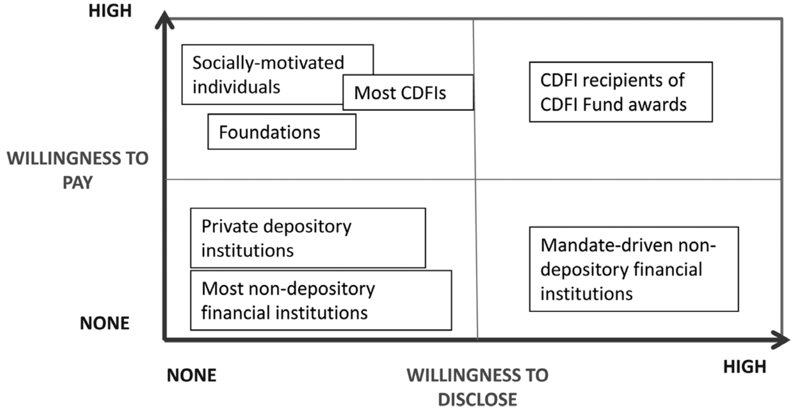

Figure 4, which illustrates the position on the two continua of the seven investor categories, as characterized by willingness to pay and willingness to disclose, provides some valuable guidance. It is clear that very few investors that place a high value on nonfinancial return are also willing to robustly measure and report that community impact. Moreover, the relationship between willingness to pay and willingness to disclose is complicated. Although willingness to disclose should and usually does increase with willingness to pay – as investors become more accountable for the higher value of nonfinancial return they seek – this is not always the case. Investors with a high willingness to pay, including most CDFIs, may believe they have nothing to gain from disclosure. In other words, their social mission, required by law, may be enough to satisfy client preferences for community impact. For investors with a lower willingness to pay, but a surprisingly high willingness to disclose, the motivation to disclose is typically involuntary – resulting from regulations or mandates. Because these investors are typically financially motivated, they are accustomed to providing a more rigorous, benchmarked, and attributable form of reporting.

By considering where investors locate in Figure 4, and cross-referencing this with the nonfinancial performance measurement tools that they currently use, our research also confirms two interesting patterns. As willingness to pay increases, nonfinancial performance measurement tends to become more widespread and more standardized. Meanwhile, as willingness to disclose increases, nonfinancial performance measurement becomes more robustly benchmarked, more independently verified, and more customized and costly. For example, investors using Pacific Community Ventures tend to have a high willingness to disclose but a low willingness to pay; investors using the CDFI Data Project generally have a low willingness to disclose but a high willingness to pay.

The precise form that nonfinancial performance measurement should take is undoubtedly unknown. The research suggests only that investor demand for nonfinancial performance measurement and accountability will, and should, determine that form. With this in mind, Figure 4 provides some final, additional insights into the likely location of innovation among investors:

- *Investors with a high willingness to disclose but low willingness to pay,* such as mandate-driven nondepository financial institutions, are primarily concerned with ensuring that they communicate with stakeholders about the real but modest nonfinancial returns they generate. These investors are likely to contribute to innovation by refining the method and the effectiveness of the presentation and reporting of nonfinancial returns, including by incorporating benchmarking and other best disclosure practices.
- *Investors with a high willingness to pay but low willingness to disclose*, such as most investing foundations and CDFIs, are likely to drive innovation in the practices they need to more accurately quantify and evaluate opportunities with highly valued community impacts, particularly for the purpose of informing internal decisions.
- *Investors with both a high willingness to disclose and a high willingness to pay,* such as CDFIs receiving government funding, are likely to drive widespread innovation. These investors are demonstrably accountable for the community impacts that they and their stakeholders value highly. This group's incentive to invest in and support innovation is unambiguous.

There are as many opinions about the form that nonfinancial performance measurement will take as there are tools, practices, and investors. According to the Monitor Institute, the priority for impact investors is to "develop rigorous metrics for assessing the relative social and environmental impact of investments and portfolios within and across the sectors and geographies that matter to them."[119] This is a very different vision from that of one interview subject, who hoped simply that "organizations see the value of collecting at least the basic data" and that "anything beyond that is icing on the cake – it's a luxury." Whatever the end game, the process is certain to be investor-centered.

4.4 How Does Nonfinancial Performance Measurement Increase Community Impact Investing?

As a final outcome of our new method for characterizing investors, it is instructive to consider the special role of disclosure.[120] Disclosure informs the relationship that an investor has with its own stakeholders, but also produces a positive and important externality: it provides latent sources of capital either "observing" or underinvested in the sector with access to market-level data to assist in valuing and benchmarking their own nonfinancial objectives. Turning to CalPERS again as an example, as a result of the high levels of disclosure in the California Initiative, every other nondepository institution is free to take note of CalPERS' performance and to benchmark their own nonfinancial return accordingly.

119 Freireich and Fulton, "Investing,"47.
120 Hagerman and Ratcliffe, "Increasing Access to Capital," 44.

This positive externality sits at the heart of a virtuous cycle of market development driven by innovation in nonfinancial performance measurement. This innovation allows investors participating in the market to more accurately value willingness to pay and to provide and demand more disclosure. More disclosure makes more information available to investors not participating in the market. As sources of latent capital better understand the value of nonfinancial return, some may enter the market with a willingness to pay, bringing more resources to the table and creating even more demand for innovation and accountability.

In summary, the very practice of nonfinancial performance measurement holds the promise of building scale in community impact investing – a conclusion with which Federal Reserve Chairman Ben Bernanke has concurred in relation to CDFIs, arguing in 2006 in a speech at the Greenlining Institute's Thirteenth Annual Economic Development Summit in Los Angeles, that "to attract more return-oriented investors, including both conventional investors and those with social as well as financial goals, CDFIs must demonstrate financial viability as well as the ability to fulfill the broader development mission."[121]

Part V: Conclusion

The community impact investing industry is made up of numerous investors, each with different preferences for achieving nonfinancial return. Investors choose investments on the basis of these preferences, which are informed by strategic, operational, and cultural priorities; outside stakeholders; and the availability of actionable data. The tools and practices they use to measure performance also vary significantly. There are three major barriers to industry-wide nonfinancial performance measurement: diverse and ambiguous investor preferences, inadequate tools and practices, and lack of accountability for nonfinancial return.

Nonfinancial performance measurement provides the information investors need to satisfy their community impact objectives. In other words, investor behavior is informed by measurement tools and practices. This investor-centered perspective shifts the focus away from particular metrics as the focal point of innovation and asserts instead that a more complete understanding of investor preferences will lead to a more robust regime of measurement. To that end, the investor-centered framework provides an important perspective from which to consider four key questions and their respective answers:

1. *Does nonfinancial performance measurement really matter for investors?*
   Nonfinancial performance measurement informs investor preferences and allows them to better express their willingness to pay for nonfinancial return. Investors must decide independently whether nonfinancial performance matters. To the extent that it does matter, high-quality data and information are essential.

121 Bernanke, "By the Numbers," 4.

2. *If it does matter, is nonfinancial performance measurement even possible?*
   Nonfinancial performance measurement is already occurring, is already informing investor behavior, and will continue to improve because of innovation.
3. *If nonfinancial performance is possible to measure, what form should measurement take?*
   Innovation in nonfinancial performance measurement is likely to originate broadly, but driving it most strongly will be investors who are demonstrably accountable for the community impacts they and their stakeholders value highly. Accountability provides a critical incentive for innovation.
4. *How will nonfinancial performance measurement increase community impact investing?*
   Nonfinancial performance measurement increases community impact investing by providing investors with the ability to better express their willingness to pay and, through disclosure, by providing latent sources of capital with the information they require to value their own preferences and enter the market.

Innovation and accountability are the primary forces advancing nonfinancial performance measurement. The key question for the field is therefore one of degree. Which of the myriad current and prospective innovations, or efforts to increase accountability, is likely to suit the largest number of investors or the most influential among them? Although we did not evaluate any specific mechanisms for increasing innovation or accountability, salient questions and opportunities for future research might include the following:

- Is the industry capable of developing a standard set of voluntary principles and best practices, including a minimum level of measurement and disclosure, in order to mitigate differences and to guide investors?
- Should CRA reform include more robust community impact measurement and reporting requirements?
- Should the CDFI Fund, the largest single investor in the industry, require all CDFIs to report transaction-level data annually, and to make this information attributable and public?
- Are there sources of additional federal government funding for innovation in nonfinancial performance measurement?

Our findings may disappoint those anxious to find the ever-elusive silver bullet to nonfinancial performance measurement, but in fact there is considerable hope. Our research does not refute the possibility of ever discovering the silver bullet; rather, it demonstrates that the industry is a long way from identifying it. Improvements in measurement will occur as investors, service providers, and government continue to innovate. Our research highlights particular steps that stakeholders can take to move the field rapidly forward. For example, investors with similar preferences for nonfinancial return can converge around similar performance measurement strategies, thereby increasing standardization within their particular structural categories and asset classes. Working groups can explore what different types of investors are seeking and perhaps shed light on the data already being collected but not disclosed. And public officials can investigate the significant impact government fiat could have on measurement innovation and disclosure.

There are certainly more questions worth asking and investigating. However, the point that bears repeating is that nonfinancial performance measurement, as it currently exists and in its possible future iterations, is indeed an important factor in scaling the industry. As industry actors better understand investors and their nonfinancial performance objectives, innovative measurement tools and practices will emerge. As a result, those investors who are observing but not yet participating in the industry will better understand both investment opportunities and their own willingness to pay for nonfinancial return, ultimately providing new capital for community impact.

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* indicates survey respondent

Making the Case for Social Metrics and Impact Investing

Margot Brandenburg
Rockefeller Foundation

In volume 5, issue 2 of this journal, my colleagues Antony Bugg-Levine and John Goldstein describe the emergence of an industry the Rockefeller Foundation refers to as impact investing. Broadly defined, impact investing is that which helps solve social or environmental problems while generating financial returns. Impact investing encompasses a broad range of sectors and geographies, but U.S. community development finance is widely recognized as one of its most mature and vibrant areas of activity.

Bugg-Levine and Goldstein provide a compelling description of the investor interest and innovation that is emerging, but they also caution that the "ability of this new industry to deliver on its potential is not inevitable." They describe some of the public goods, private services, and collective action that must take place if this new industry is to realize that potential. They make the case that credible standards and tools for measuring social impact are vital for the industry's success.

As the designated "metrics person" on the Rockefeller Foundation's Impact Investing team, I am often asked to elaborate on this high-level claim about the importance of social metrics by providing a more detailed description of what is needed, and of the initiatives (including IRIS and GIIRS) that are taking place to meet those needs. For those who have an appetite for detailed conversations about metrics, an interesting dialogue generally ensues. For the majority, however, theirs is a limited attention span for topics such as the IFRS-like taxonomy needed to standardize impact-related terms, or the trade-offs implicit in developing the weights for a fund-level impact rating methodology. People, I find, believe that nonfinancial performance measurement is essential in principle, but they are eager to defer further conversation to the social metrics person at their institution.

Measuring social and environment impact is extremely complicated and is appropriately considered the purview of experts. However, metrics experts must engage, and receive support from, the broader industry community, given that:

- the success of impact investing may well hinge on our ability to meaningfully and credibly capture, track, report, and measure social and environmental impact; and
- establishing common reporting and performance standards requires wide-scale adoption.

Democratizing the arena of social metrics makes it incumbent upon those of us who do focus on it to find simpler, more accessible ways to describe some of its nuances. However, we also need to to convince industry participants of what is at stake and that they should engage in some of the details. Lisa Hagerman and Janneke Ratcliffe, also in volume 5, issue

2 of this journal, make a compelling argument for measuring social impact. Doing so, they argue, can help reveal the positive correlation between impact (or proxies for impact) and financial return. For some investors–particularly institutional investors such as pension funds–this may always be the most compelling rationale. However, this argument is not the only one, and it precludes investments that do not provide a market rate of financial return. I believe we can and should make a broader case.

Making that case can be challenging. Social scientists, for example, often express concern that standardized measurement tools risk omitting, or even worse, misrepresenting, important dimensions of social change. Some bristle at the misappropriation of the term "impact," which they argue requires detailed (and usually expensive!) information on outcomes and attribution. Nonprofit organizations or community groups may worry that an overreliance on quantitative measures will cannibalize interest and funding for activities that result in more qualitative outcomes. These concerns are valid, and should be considered when developing standards and tools. However, they are better addressed in a future publication given that they cannot be done justice here.

Struggling to keep the attention of a lay investor audience and often subject to suspicion from academics, impact investing metrics enthusiasts sometimes find it challenging to engage the breadth of people that must be invested in their success. It is imperative to find simpler, more accessible ways to describe some of the nuances of impact metrics. One option I have often found helpful is to describe a few "doomsday" scenarios in which appropriate and widespread standards for measuring impact do not materialize. These doomsday scenarios include:

Impact investing enables green-washing. In the absence of meaningful social and environmental performance standards, impact investing becomes too easy. Capital flows to companies and funds that produce annual reports or investment prospectuses with the most compelling photographs on their covers, rewarding (and creating incentives for) competencies in public relations rather than activities with real impact.

Apples cannot be distinguished from oranges. Standard definitions for impact-related terms do not take root across the industry, and individual companies and funds must use their own definitions and terms for reporting on impact. Investors cannot meaningfully compare one company or fund's performance against another. Industry benchmarks cannot develop, which deprive companies and funds of a meaningful management tool and deprive investors of critical information on which to base investments. Companies and funds that produce truly impactful activities and outputs are unable to distinguish themselves.

Impact investors must staff PhDs in program evaluation. If industry participants set a high bar for the integrity and accountability of their nonfinancial impact (as we hope they will) but third-party standards and tools do not develop, each will be required to internalize expensive measurement and evaluation functions for which they are generally not well suited. This will drive up costs for the few that choose to do it, and is likely to prove prohibitively expensive for the majority. In addition, bespoke measurement systems will lack comparability, as described above.

The right matchmaking does not take place. Impact investors are diverse in many ways, including in the relative priority they place on generating social or environmental value versus financial return. Those investors who are or may be "impact-first" (such as foundations making program-related investments, family offices, private clients, or even retail investors) may be willing to accept a lower rate of financial return if they have reasonable confidence in the investment's greater social or environmental impact. Other investors may necessarily prioritize risk-adjusted financial return and be content with moderate impact. Absent credible information to differentiate degrees (or even orders of magnitude) of impact, it is impossible to situate potential investment opportunities along any kind of continuum. Impact-first investors are unable to optimize their social impact, and "finance first" investors may find the market distorted by competition from concessionary capital.

Policymakers cannot serve as allies. An enabling policy environment for impact investing (through mechanisms such as preferential tax treatment, government guarantees, expanded or revised regulations) cannot develop because policymakers lack the ability to distinguish this category of investment from other investment activity. Sector-specific regulations such as the Community Reinvestment Act may continue to develop in silos but their reach and application will be limited.

Although it is easy to identify the shortcomings of any particular set of tools and standards, I think most of us would agree that not developing them presents a greater threat to the industry's success.

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CRA Modernization and Impact Investments

John Moon
Federal Reserve Board of Governors

Bank regulators are currently reviewing public comment on the Community Reinvestment Act (CRA) to determine what regulatory changes, if any, might be made to this law that has served as a pillar in the community development field. In its first iteration, the CRA addressed the fundamental challenge of inputs – simply getting capital and financial services into low- and moderate-income (LMI) areas. In its second iteration after several major changes, the CRA focused on how to better measure activities that improve communities. In what may be its third iteration, the CRA must focus on measuring outcomes and impact; in other words, to what degree has CRA-motivated lending and investing successfully improved communities?

CRA-motivated banks and the rapidly growing social impact investments field have overlapping and complementary objectives and challenges. On one hand, this nascent social impact investments movement faces similar challenges that the early community development movement faced, such as creating intermediaries, building a supportive ecosystem, establishing a track record, and creating the right assessment tools. On the other hand, the social impact investments movement is on the cusp of becoming a standard bearer through the sheer size of its potential investment activities (estimated to be $500 billion within the next ten years), its intellectual and innovative vibrancy, and the growing professionalism of this field. The potential challenge and opportunity for the community development industry will be to realign itself to tap these new funding sources by adapting to shifting investor expectations for impact-based outcomes. Similarly, the CRA must also adapt to this potential funding shift within the community development industry.

CRA History

A lack of lending in LMI communities stemmed largely from discriminatory practices and the perception of excessive investment risk in these areas. In the mid-1930s, banks identified geographic regions as high-risk and, as a matter of bank policy, did not lend in those "red-lined" regions. In 1961, the "Report on Housing" by the U.S. Commission on Civil Rights documented bank practices of requiring higher down payments and rapid amortization schedules for African Americans, in addition to blanket refusals to lend in certain areas. The Community Reinvestment Act was passed in 1977 in response to worsening economic conditions in urban areas, and to redress lending practices whereby financial institutions accepted deposits from households in their local communities but did not lend or invest in those very communities.[1]

Congress instituted a quid pro quo for access to the Federal Reserve discount window and FDIC insurance by requiring financial institutions to provide services and capital to underserved markets. In its 30-year history, the CRA has achieved its goal of increasing capital access to LMI and underserved communities. According to some studies, the changes made in the mid-1990s to make CRA more transparent coincided with an increase in annual lending commitments from $1.6 billion in 1990 to $103 billion in 1999.[2] According to a study by Harvard's Joint Center for Housing, the CRA expanded access to residential mortgages for lower-income borrowers.[3] Another study concluded that the CRA has been effective in helping to overcome market failures and reduce discrimination at a relatively low cost.[4]

Although the CRA is a critical regulatory tool in promoting the flow of capital to LMI areas and in supporting the community development industry, the CRA has not kept pace with the significant changes within the financial services industry. Bank consolidation and the growing dominance of national banks along with the impact of technology have made the notion of serving local markets where banks take deposits seem outmoded. With the growth of securitization, non–CRA-regulated financial institutions were able to penetrate LMI communities with lending products. In 1990, non–CRA-regulated institutions originated 17 percent of mortgage lending. By 1993, at its peak, non–CRA-regulated institutions originated 40 percent of mortgages. Many industry observers suggest that these non–CRA-regulated institutions maintained a competitive advantage over CRA-regulated banks in originating loans, many of which were subprime, to LMI individuals because of the relative lack of supervisory scrutiny. At the same time, the emergence of other non–CRA-regulated, non-bank financial service products such as pay-day loans, check cashing services, remittances, and other potentially predatory products also proliferated in LMI communities. As a result, the challenge for the community development field has changed since CRA was enacted from one of access to credit to the availability of fair and quality credit.

The Rapid Growth of Social Impact Investing

The rapid growth of social impact investing, with its emphasis on delivering impact, is

1 The CRA affirms the obligation of federally insured depository institutions to help meet the credit needs of their communities, including LMI areas, in which they are chartered. To enforce the statute, the four federal regulatory agencies examine banking institutions for CRA compliance, and take this information into consideration when approving applications for new bank branches or for mergers or acquisitions.

2 National Community Reinvestment Coalition CRA Commitments (Washington, DC: NCRC, September 2007). Availabe at www.community-wealth.org/_pdfs/articles-publications/cdfis/report-silver-brown.pdf.

3 William Apgar and Mark Duda, "The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges" FRBNY Economic Policy Review, 9 (June 2003): 169-91. Available at http://www.newyorkfed.org/research/epr/03v09n2/0306apga.pdf

4 Michael S. Barr, "Credit Where It Counts: The Community Reinvestment Act and Its Critics," *New York University Law Review* 80 (May 2005): 513-652. Available at http://www.law.nyu.edu/journals/lawreview/issues/vol80/no2/NYU202.pdf'

poised to be an evolutionary step in providing capital to intermediaries and firms that spur social innovation. A recent Monitor Group report states, "using profit-seeking investment to generate social and environmental good is moving from a periphery of activist investors to the core of mainstream financial institution," with a potential market size of $500 billion within the next decade.[5] Socially motivated investors (retail and institutional) are actively seeking to invest in funds and enterprises that tackle social challenges such as early childhood education, environmental sustainability, workforce development, and a range of other activities that create social value. These investors expect some balance between financial and social return, or what is often referred to as "double bottom line" returns.

Of the many elements needed to build this marketplace, a key one is standards that measure social return so investors can gauge the relative impact of their investments. Indeed, several tools have been developed to measure social impact in recent years. Leading examples include the Rockefeller Foundation's Impact Reporting and Investment Standards (IRIS) system that brings together social enterprises to develop a common framework to capture impact. Another is the Global Impact Investment Rating System, an international platform similar to the services provided by ratings agencies such as Standard and Poor's and Morningstar. Within the community development field, the Opportunity Finance Network's CDFI Assessment and Rating System, or CARS, and the National Community Investment Fund's social performance metrics were developed to address the desire to track impact.

The CRA, however, continues to focus on bank actions, such as the number of mortgages closed in LMI areas or the number of small businesses funded, rather than the impact of these loans. Indeed, a common refrain at many of the recent public hearings on the CRA is that it overemphasizes activity tracking and does not adequately recognize or encourage activities that have significant community impact. Mark Willis, who once headed the community development and CRA departments at a large national bank, offered this critique:

> While the addition of such qualitative criteria as innovation, complexity, responsiveness, and Performance Context were intended to allow for more nuanced judgments, the reality has been disappointing. Quantitative tests tend to dominate the exam process perhaps because examiners either lack the authority to give qualitative factors the appropriate weight or because they naturally gravitate toward quantifiable measures that are easier to defend…. The results have been that projects that have great community impact may not go forward simply because a bank will not receive credit sufficient to justify the effort required.[6]

5 Monitor Institute, "Investing for Social & Environmental Impact: A Design for Catalyzing an Emerging Industry (San Francisco: Monitor Institute, 2009), 3.

6 Mark Willis, "It's the Rating, Stupid: A Banker's Perspective on the CRA." In *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act* (San Francisco: Federal Reserve Banks of Boston and San Francisco, February 2009).

The social impact investment movement is positioned to address this problem and influence how the community development industry might track its impact. Effective efforts to measure social impact for investors may be driven, in part, by the lure of significant new funding for the community development field. For example, the Calvert Foundation is raising funds from institutional and retail investors through the sale of its Community Investments Notes, with proceeds invested in Community Development Financial Institutions (CDFI) intermediaries. Through this channel, Calvert's managed assets have nearly doubled in just four years, in spite of the economic recession. These new impact investors seek measurable social impact and, to further tap these funds, the community development industry will need to develop a common framework to report impact to this new investor class.

As bank regulators contemplate potential changes to the CRA regulations, consideration should be given to how the CRA could align itself with this likely shift to impact-based measurement and reporting. It is beyond the scope of this paper to make specific detailed recommendations, but it is critical to bring stakeholders together to share ideas that may lead to potential breakthroughs. The following are some ideas about potential benefits and opportunities:

- Admittedly, creating a standard set of impact measurements is inherently difficult, but doing so could spur, or at least complement, the broader use of standard metrics by social impact investors. CRA could work hand-in-glove with the impact investing world, but this would require much more cooperation and coordination than currently exists. For example, CRA could require banks to use some aspects of evolving impact measures, such as IRIS, GIIN, CARS, etc. It might also provide carrots to "opt-in" to some of those measuring systems. Conversely, impact investors could use CRA data and ratings to help capture community impact. In other words, the two communities could place expectations on each other that would help bring their worlds together in action, a world they already share in terms of their goals of improving the lives of low-income individuals and communities.
- The benefit of this partnership cannot be overstated. The impact investment world could supercharge the role that foundations have traditionally played: as sources of capital for higher risk/higher reward strategies to solve problems of poverty and disinvestment. Banks, on the other hand, are not in the experimenting business (and for good reason); they are in the system building business. When concepts are proven by high risk capital, banks can enter the marketplace with their size, reach, expertise, and systems and make what seemed almost impossible (lending to charter schools, homeless shelters, innovative small businesses, green retrofits, community clinics) into something that is routine. Banks are uniquely positioned to provide the sheer size of investment necessary to make the comprehensive and systemic changes that struggling communities need. Identifying the right incentives via the CRA would be an important first step.

- Getting the incentives right so that the CRA can evolve to encourage innovation requires that these incentives are in line with those of the impact investment world. Right now, the focus on numbers (outputs) ranks the same as an investment in a targeted mortgage-backed security and a high-risk/high-reward investment in an innovative charter school experimenting with wrap-around services to keep low-income children reading at grade level. A new regime that captures outcomes would reward the latter more, and create incentives for banks to become better partners with the impact investing community that cares about these innovative strategies.

Conclusion

As CRA modernization is considered to better reflect the significant changes within the financial services sector, there should be equal consideration of the new landscape of the community development sector. The growth of social impact investments and their potential influence could begin to change how the community development sector acquires capital. Many promising innovations are already taking place, such as greater access to retail investors who are interested in placing capital into double-bottom-line investments. Of the various investment criteria that these new investors will require, social impact will be a key determinant, and organizations must be positioned to provide such reporting. In addition to the obvious benefit of bringing more money into community development finance, social metrics will also provide the necessary feedback for community developers to ensure that all investments in low-income communities are spent in the most efficient way. The CRA could be an important catalyst to forming this marketplace, or it could be a relic of a bygone era of community development investments.

John Moon *is a senior community affairs analyst at the Federal Reserve Board of Governors, where he focuses on community development finance and investment matters.*

Impact with Punch: The Perfect is the Enemy of the Good

Arjan Schütte
Core Innovation Capital

After around 40 years of institutional "impact investing" it is distressing that "impact measuring" is hardly de rigueur. While impact investment managers understand clearly how to measure financial returns, the best practices, systems and compliance in measuring the social benefits are anemic, at best. And what does exist often attempts to boil the ocean, measure the unmeasurable, is at odds with operational goals, or is limited to a couple data points or an anecdote. We have tried to tackle this issue with our recently launched double-bottom line venture capital fund, Core Innovation Capital. The following ideas are aspirational for our company as much as they are for this industry.

One Size Does Not Fit All

A recent and enduring trend seeks to universalize impact measurement attempting to mimic the universality that exists in financial metrics. Hospital beds, solar panels and alternative payday loans all have customer acquisition costs, profit margins (or lack thereof), and ROI even though these numbers vary. They do not share much in the ways they attempt to improve the quality of life. Valiant efforts like B-Lab and Rockefeller's Global Impact Investing Network are taking on the herculean task of identifying universal impact attributes, with some success. I believe finding universal attributes within sectors – e.g. health care, alternative energy, financial inclusion – will yield far greater benefits by decreasing the cost of compliance, creating better proxies for impact (comparing apples to apples), and intra-sector benchmarking. To take a simple example within the financial inclusion, there are more than enough challenges simply to figure out how to measure the differing impacts between a better form of credit on someone's life versus an emergency savings account. At this point, finding metrics that extends to all sectors is likely too ambitious.

Forget Impact, Focus on Output

Similarly lofty, and impractical, is the practice of trying to actually measure impact. Impacts are the actual, positive changes in the perceived environmental and social problems. How does the alternative payday loan actually improve someone's life? How much does a residential solar installation really impact global warming? We can agree they probably do, but really how? Figuring that out in a meaningful way could cost more than the actual product or service. Instead, measuring the outputs – the products and services delivered by the companies we invest in – can be done at a reasonable cost and done consistently. Measuring outputs over time also positions our industry to develop better theories of how we create long-term impact.

More of Less is Better Than Less of More

I perceive a clear tension between long-term compliance and academic rigor, and place my bets on the former. I'd rather track two good outputs consistently over many years than kill myself badgering our entrepreneurs for 200 data points, which tell a more complete story only once or twice. I would much rather our portfolio entrepreneurs spend their time increasing their outputs than report, which is also something most good entrepreneurs instinctively despise (not necessarily a good trait, but nevertheless a reality).

Align Metrics with Operational Objectives

Even in impact investing, Peter Drucker's axiom, "what gets measured, gets managed" is not just true, but powerful. That is, as long as what gets measured is relevant to an organization's operational success. This is not always possible, but impact investment managers have an opportunity to do what they can to align the two. For example, tracking the income of end-users is an important data point for our fund, but this data rarely helps our companies be more successful. Consequently, compliance is harder and the utility of collecting the data is limited. On the other hand, tracking how effective a debt management's solution is at actually decreasing its end-users' debt is not just a useful output for us to evaluate the company's impact, but also a powerful metric of customer satisfaction, longevity and profitability. The panacea of alignment, of course, is not just to align metrics with operational success, but to align metrics directly with financial success.

Incentives for Leadership

Finally, if you concede that true impact measurement is largely ineffable, we are missing a big opportunity by focusing only on metrics. Creating incentives at both the operational (the companies we invest in) and at the fund level for taking leadership in increasing impact is potent and underutilized. The National Community Investment Fund has done more creative work here than I have seen anywhere. And we have built it into our fund: my partner and I have tied part of our compensation and upside to impact success, as determined by an impact audit that follows the values described here.

Arjan Schütte *is the managing partner at Core Innovation Capital, a new double-bottom line venture capital fund specializing in financial services for the un- and underbanked in the United States. He is a successful social entrepreneur and nationally recognized expert on domestic financial inclusion. Arjan earned a BA in Philosophy from Lewis & Clark College and MS from the MIT Media Lab.*

Who Cares about Social Impact?

Penelope Douglas
Pacific Community Ventures[*]

In a dozen years at Pacific Community Ventures raising capital for our own venture capital funds, and advising clients regarding how they might measure and communicate social impact, I keep returning to the question of who really cares about social impact?

Few publicly owned financial institutions or large institutional investors invest their dollars to create both financial returns and social impact starting from a deeply rooted theory of change. This does not mean the institutions lack passionate individuals, or that they are not committed to bettering their communities, but it is simply not how investment funds are built.

Social impact is important for fund managers to articulate when it is important to those from whom they raise capital, or because they are required to report on community investment outcomes. Banks must measure their community impact in order to meet reinvestment goals as outlined in the Community Reinvestment Act of 1977 (CRA). However since fiduciary obligations are (in these cases) the primary focus, eliciting social impact is most often an exercise to augment successful investments as they are completed. Data is gathered in order to prove that investments add social value.

But how much more powerful and effective could investors be if they built their social impact investment models from the bottom up? In other words, start the discussion about what to invest in at the base of their investment dollars? By powerful and effective I mean more effective investments, I don't mean sacrificing investment objectives in service of a bottom up approach.

How would answering this question play out in practice? In the case of banks, this would mean surveying the smallest dollar depositors and least served community members in order to build an investment strategy. The purpose of the strategy would be first to deliver on the intentions of the institution's CRA commitment. In the case of insurance companies, this would mean surveys of all individuals as well as larger policy holders, to learn what social impact is most valued by these stakeholders. What do they want their money to do besides be well invested? And for pension funds, this means holding deep dive discussions with the workers who make up the pensioner population of the future--those contributing their service time and dollars to the funds.

This type of investment strategy also allows the stakeholders to make a statement with their money. If an individual can work with a financial institution to determine its investment priorities, and these institutions are responsible for reporting on outcomes, each of us

[*] Thanks to Lauren Friedman for her assistance with this essay.

can better decide what to do with our money, and with whom to invest. In the end, bottom up investment strategy results not only in greater institutional transparency, but allows each of us to invest, or make our CD and deposit choices, based on alignment with the social outcomes we believe are most important.

Who knows if this approach would change the mindset of publicly held institutions, fund managers, and pension funds? Based on years of double-bottom line investing, I think it would.

I believe there would be powerful implications for investment strategy. Such bottom up surveys could yield comprehensive strategies for environmental, educational, health, and infrastructure investing. The financial success of these strategies yields both direct and secondary financial, and both direct and secondary social benefits to the fund and its members. Equally importantly, the objectives would tie stakeholder to fund manager. This makes good sense because the daily financial decisions of the stakeholder are aligned to the investment strategy of the fund in pursuit of common goals.

Also, I suspect gathering the wisdom of investor stakeholders would make it easier to identify emerging markets along with new consumer trends.

The exercise of identifying stakeholder values would certainly assist in aligning interests from bottom to top, and without a doubt, impact positively a culture of transparency. And, there is no better time for this transparency given that so many of the working population are embittered by what they perceive to be the machinations of self-dealing corporate and financial interests.

Penelope Douglas *co-founded Pacific Community Ventures in 1998 and has been actively involved in mission focused investing since that time.*

Social Metrics in Investing: The Future Depends on Financial Outperformance and Leadership

Allison Duncan, *Amplifier Strategies*
Georgette Wong, *Take Action!*

Introduction

In order to truly unlock the potential of the impact investing industry, social/environmental metrics must be directly connected to financial outperformance. When above-market rate–or premium–financial returns are present, large fiduciaries such as public pension plans (who globally hold a total of $23 trillion in assets), are able to invest and the impact investing market will move beyond its current niche. Products and services that present solutions to the increasing constraints on natural resources and unmet basic human needs will be a major driving force for our economy. While there will be numerous investment opportunities that claim both premium financial returns and social/environmental benefit, non-financial metrics will enable us to distinguish the "pretenders" from the "real deal."

The scale of the emerging opportunity in alternative energy alone is immense. As John Doerr of Kleiner Perkins Byer & Caulfield stated in September 2010, "The energy market is $6 trillion, worldwide, with 4 billion users of electricity. It is the mother of all markets. Compare that to the internet economy, estimated at $1 trillion worldwide with 1.5 billion users." Many many more asset owners – including pension plans, foundations and families – express interest in the long-term sustainability of their investments.

In order to move forward and succeed in developing appropriate metrics and measurements, we need leadership from all parts of the investment ecosystem, but most specifically asset owners, intermediaries, and businesses. While the growing demand for impact investments presents an opportunity to leverage large capital for social and environmental good, it will never replace the critical role of governments, philanthropy, and community development to bridge the gap that addresses challenges that cannot be met by market mechanisms.

Impact Investors: Growing Demand and Divergent Interests

Impact investments seek to generate financial returns while also creating social and environmental value across all asset classes. Attention on this emerging industry has grown over the last few years as asset owners have been searching for alternatives to the "traditional" financial markets, which collapsed in 2008-2009. In addition, asset owners are interested in exploring how impact investments can play a role in responding to current global crises – the floods in Pakistan, the Gulf oil spill, the earthquakes in Haiti – as well as ongoing chronic crises such as poverty and climate change. Impact investing has been featured in prominent news coverage during 2010, including the *New York Times*, the *Wall Street Journal*, and the

Financial Times. It has also been the subject of several recent notable publications, including *Investing for Social and Environmental Impact, Solutions for Impact Investors: From Strategy to Implementation,* and *Philanthropy's New Passing Gear: Mission-Related Investing*.

The potential size of the market is large: Global pension plans alone represent $23 trillion in assets compared to US foundation assets of $550 billion. The high net worth market (defined by Merrill Lynch and CapGemini as investors worth more than $1 million) is valued at $39 trillion. As a result, impact investing represents the single biggest opportunity for capital to unleash the power of the private sector and of entrepreneurial innovation to solve some of society's toughest challenges.

Impact investors, however, bring a wide range of divergent interests and priorities. Just as there is a continuum of expectations for financial returns (ranging from premium to sub-market rate), there are also degrees of expectation for social and/or environmental impact (ranging from a large degree of alignment to values and/or mission to very little). The market is in early stages and this continuum has no clearly accepted or delineated categories of "high" or "low." Thus, beauty is truly in the eye of the beholder. Given the many motivations and preferences, social and environmental metrics enable investors to understand if their expectations are being met on social and environmental criteria. Finding a way to measure social and environmental impact is essential for providing a mechanism through which investors can assess, compare and make investments as well as for tracking progress and making course corrections where needed. This is not unlike standard financial benchmarks, where it is clear whether or not one is above, at, or below expectations. If we can truly bring together the development of these metrics with above-market rate returning investments – and better yet show how these metrics create positive financial value – then impact investing will be poised to unlock large dollars and enter the mainstream.

The Importance of Defining the Relationship between Metrics and Premium Returns

The development of metrics is important for beginning to explore how and whether social and environmental metrics are drivers of financial outperformance. If such a link can be established, then capital will undoubtedly begin to flow into the field, first from investors looking for returns and secondly as additional products begin to mimic the successful impact investments. As the cycle continues, investors will be able to compare strategies and products, and determine which ones are of the highest quality. The result is a higher bar and standard for practices in impact investing in particular, and for investing in general. It is at this point that the social and environmental measurements will play a crucial role in differentiating the products that are "pretenders" from those that are truly making a difference.

Today, there are a few products that can make investors money and create the desired social/environmental value in selected issue areas. Tomorrow, we envision products that make investors money because of their social and environmental benefits. There are at least three obstacles to this vision becoming reality: 1) the depth and breadth of investment products; 2) messaging and marketing these products; and 3) translation of externalities into meaningful financial measurements.

The most well-known impact investments tend to be either private equity funds that range from $50-250 million in assets under management or public equity/fixed income investments that hold $1.5 billion or less in assets. While many of these funds are doing groundbreaking work, their size naturally limits the amount of capital that they are able to invest. There are two paths to increasing the size of the investments: enable the current managers to grow their assets under management, or enable "traditional" fund managers who manage more than these amounts in capital to incorporate some of these criteria into their investments. Both operational excellence at the level of institutional asset management and on-the ground know-how of these investments are critical to moving impact investing beyond its current niche.

Messaging and marketing these investment products continues to be a challenge for two reasons. First, the current dominant paradigm says that one invests money to earn the greatest return and then to give away the "excess" for philanthropic motivations. Until this understanding shifts to a new paradigm that recognizes that investments can create the highest returns and social and environmental benefits, investment managers need to choose their messaging carefully. If they do not address standard traditional financial language to which institutional investors are accustomed, then they run the risk of being perceived as products that are not "true investment grade." If the products emphasize the social and environmental benefits or thesis without tying it to investment returns, then they may be miscategorized as philanthropic. Second, although the dominant paradigm is evolving, change is still slow and uneven. To be successful at raising new funds under the current paradigm while transitioning to this new paradigm, managers must know their audience. Angels, high net worth families, foundations, pension plans, corporations, and other investors have different structures, cultures, values, financial return criteria and asset allocation strategies which dictate their investment decisions. Thus, it is not surprising that there are currently no clear best practices for presenting investment solutions to impact investors. There is an emerging trend for some institutional investors to require transparency from investment managers to disclose externalities, including their reporting about the use of environmental, social, and governance (ESG) factors. Likewise, the Carbon Disclosure Project (CDP) is creating a platform for corporations, investors, and governments to transparently measure and report their greenhouse gas emissions and climate change strategies. According to their website at the time of this publication, the CDP is currently acting on behalf of 534 institutional investors holding $64 trillion in assets under management, and some 60 purchasing organizations. However, reporting ESG factors and participating in the CDP and other initiatives is currently voluntary.

As local, state and national governments advance policies that require the efficient use of natural resources and implement limits on greenhouse emissions and other pollutants, standard financial reporting requirements will be expanded to include these sustainability factors, their associated business risks, and planned mitigations. Many companies will also be able to develop assets by integrating sustainability factors into their innovation processes, supply chain management, distribution channels, and brand management. The future disclosure of these externalities - whether mandated by accounting standards or adopted by companies to create their competitive advantage - will enable investors to evaluate how companies and investment vehicles are balancing short-term profitability and long-term viability, all in pursuit of shareholder value.

How do we move forward?

Leadership is critical to overcoming the obstacles we outline above and in furthering the link between social and environmental metrics and their contribution to premium returns. We need to start with leadership from three key and interrelated groups:

> ***Asset owners*** play the critical role in demanding financial returns and social value measurement and transparency, given that it is their money that is being put to work. In addition, asset owners may lead the development of nonfinancial metrics in three ways: 1) voicing in clear terms their desire for them; 2) sharing openly their criteria for investment decisions; and 3) pushing for the integration of premium financial returns and social/environmental returns. Ultimately, asset owners lead by investing their capital when the investment product meets their criteria. Whether in small or large amounts, as a separate carve out or not from their traditional investment strategy, the most important thing is to start. Only by doing so will we be able to begin to compare investments, determine which ones meet standards on both financial and nonfinancial levels, share learnings, and advance the field.
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> ***Businesses (potential portfolio companies)*** working on the ground may have the clearest picture of current opportunities for social and environmental impact – and profit. In order for businesses to tap into potential investment from impact investors, these entrepreneurs must develop and articulate proof of premium financial returns, articulate a disciplined approach to unlocking value, and demonstrate their ability to create impact. To fulfill on the latter, a robust measurement methodology, a disciplined approach to gathering information related to social and environmental impacts, and excellent reports back to investors are required.
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> ***Intermediaries*** (consultants, advisors, and investment managers) play a crucial role in bringing the asset owners and businesses together. Whether funds or funds of funds, investment managers and financial advisors must work closely with portfolio companies in order to define a comprehensive investment thesis, including a clear articulation of what impact different investment levels will achieve and how this will be measured. They need to facilitate the conversation, and match the values, interests, and investing structures of asset owners with opportunities for impact. Finally, in order for the impact investing industry to grow and succeed, the entire field of intermediaries will also need to grow and evolve so that there is the breadth and depth of professionalism in the field to seek and measure both financial and nonfinancial returns.

Conclusion

Currently, only a small set of asset owners, typically families and foundations but increasingly large pension plans as well, place their capital in impact investments. While additional funds from families and foundations may be brought in if there is a systematic way of understanding how much impact the investment generates, impact investing will remain a niche market until large pension plans and other institutional players adopt impact investing. In order for that to happen, premium financial returns must be coupled with social and environmental returns. In the best case, social and environmental performance is directly linked to the creation of outperformance.

An additional challenge is that investment managers do not have a financial incentive to gather the appropriate metrics. Tracking social and environmental metrics is more work, more costly, and is not straightforward. Additionally, the current incentive structure for investment managers and consultants is designed to reward only financial performance. In order for impact investing to succeed, social and environmental metrics must be demanded by asset owners, and the reward system needs to be adjusted so that managers and consultants are incentivized to collect and provide social and environmental metrics. The right policies may be one potential solution for setting the stage. For example, investors have an incentive to engage in impact investing if tax deductions for microfinance investments are enacted.

The impact investing industry is at an important juncture. There is an opportunity to attract major financial investments into the space by weaving financial and social/environmental gains together. What we need now is leadership – to develop the social and environmental metrics, report them transparently, link them to financial outperformance, and shift the fundamental rewards structure of the investing field.

Allison Duncan *is the founder and CEO of Amplifier Strategies, a consulting and technology firm that specializes in helping foundations and investors increase their social and environmental impact. She is known for her expertise in creating and implementing program strategies, developing public/private financing partnerships, and measuring program performance. She has worked with businesses, NGOs, and government agencies in more than 20 countries and continues to pursue her mission globally. Allison is currently advising clients on program strategies with funding in excess of $500 million.*

Georgette Wong *is the CEO of the Take Action! Impact Investing Conference series and a leading speaker on trends in impact investing. Founded in 2007, Take Action! is the pre-eminent gathering of impact investors focused on premium returns. This by-invitation only community is composed primarily of asset owners from families, foundations, major pension plans and corporations. Together, these industry leaders exchange stories of success and failures, debate ideas and investments, and make the connections they need to move to their next level of success. The 2010 event brought together investors representing $4.1 trillion.*

Investing for Good: Measuring Nonfinancial Performance

David C. Colby and Sarah G. Pickell
Robert Wood Johnson Foundation

It is said that Quakers came to America to do good, but did well. The community development field does well, but could be strengthened by demonstrating how much good it does. Except when funded by a foundation or similar institution, often times the prime measures of success for community development are financial performance measures. By contrast, for those of us who work in the field of health, understanding our impact generally requires the measurement of nonfinancial impacts. And for some of us, it is even trickier because we work at institutions that are neither accountable to markets nor to the electorate. Our work involves valuing things that are thought to be "priceless."

What is this peculiar work that is neither governed by markets nor the electorate? It's philanthropy. We work at the Robert Wood Johnson Foundation (RWJF). Robert Wood Johnson II was the leader who transformed Johnson & Johnson, a small family-owned company that produced bandages, into a significant national corporation. But he also had been a small town mayor, a Brigadier General, a writer, and a local philanthropist. After his death, his will directed that his estate, valued at $1.2 billion during probate, be given to create the Robert Wood Johnson Foundation. At that time, 1972, it was the second largest foundation in America behind the Ford Foundation. Since then, the Foundation has worked on improving health and health care of Americans and today has assets over $8 billion.

In this issue of the *Community Development Investment Review,* Ben Thornley and Colby Dailey describe the case for measuring nonfinancial returns of community development investments. To provide the community development field with one example of how to approach this, and to provide a perspective from another field, we will describe the commitment of the Robert Wood Johnson Foundation to measuring its impact. In addition to the reasons for measuring nonfinancial returns that Thornley and Dailey provide, our experience shows that there is another important reason for measuring nonfinancial impacts: to help spread a program model.

Evidence-Based Decision-Making

Evidence-based decision-making is part of the DNA of the Robert Wood Johnson Foundation. From the beginning, the Foundation relied on clear evidence to inform its decisions and meet its commitments. Many of the early trustees of RWJF came from the pharmaceutical industry. In that industry companies must answer questions about the effectiveness of drugs. Similarly, after former Johnson & Johnson executives joined the Foundation's Board, they asked whether each Foundation program was having an effect. Although it is more difficult to prove social programs are having an impact, RWJF staff responded by funding program evaluations conducted by independent evaluators. These evaluations enabled the Foundation to make better decisions about its investments and to improve its programs, leading to more constructive social change. Also, to guide investments and strategy, research initiatives provided timely evidence to inform practice and policy in many areas critical to RWJF's mission to improve the nation's health and health care.

In addition to the Board's interest, the evidence-based approach of the Foundation reflects the fields of health and health care, which have valued the use of metrics. British physician John Snow's use of statistics in the 1850s to identify the source of a cholera epidemic established epidemiology. Boston physician Ernest Codman's use of performance metrics to improve hospital care in the early part of the last century led to the development of quality improvement in health care.

Research and evaluation play important roles to inform decision-making; they are crucial components of RWJF's thinking and strategy. Simply, the Foundation uses these to answer two questions: 1) What is the problem?, and 2) What solutions work?

What is the problem? The Foundation uses research to answer questions about the nature of a problem. Research enables the Foundation to understand a problem by assessing what the problem is, who is affected, and how it can be addressed. Below we provide two examples, from health insurance coverage and childhood obesity, to illustrate the use of research to define or clarify the problem.

Health Insurance. Covering the uninsured has been a major focus of the Foundation, especially in the last twenty years. As the largest foundation devoted to health and health care, RWJF has funded a significant amount of research on health insurance. The Foundation saw this research as serving two important functions. First, the research built a knowledge base, helping policy makers understand who is uninsured and why. Second, by focusing on the consequences of being uninsured, the research created an empirical case for health care reform. Certainly, since President Richard Nixon's proposal to expand health insurance coverage in 1974, the issue was often discussed in policy circles; the research provided a common starting place from which conversations about the issue could begin.

Several research efforts on national questions, including Changes in Health Care Financing and Organization and the Economic Research Initiative on the Uninsured sought to understand the financing and economics of health care and its delivery. The Center for Studying Health System Change tracked insurance coverage and health care systems' impact on an individual's access to care. These research efforts established a knowledge base, easily accessible and serving as a guide to policy makers when issues arose. Another important research investment on insurance coverage was the Foundation's support of the Institute of Medicine's (IOM) reports from 2001 to 2004 on the consequences of being uninsured. In the early 2000s, there was evidence about the impact of being uninsured but it was unpersuasive. The Foundation funded the IOM to deliver a clear, accurate, and research-based picture of uninsurance in America. The IOM was seen as a credible body that could portray the evidence soundly and rise above the political arena.

To understand the issue and how it varied across states, the Foundation funded the National Survey of American Families and State Health Access Data Assistance Center. The survey provided an understanding of health insurance at the state level and the significant differences across the states. State Health Access Data Assistance Center provided technical assistance to states to better understand the federal data regarding the nature of the problem in their state.

Childhood Obesity. Research also has proven instrumental in a second, newer area of Foundation interest – reducing childhood obesity. In 2007, RWJF made a commitment of $500 million to reverse the childhood obesity epidemic by 2015. Before the epidemic of childhood obesity could be reversed, however, the Foundation needed to better understand the problem. Two on-going research initiatives were launched: Healthy Eating Research and Active Living Research.

Healthy Eating Research supports research on the influence of environmental and policy factors on promoting healthy eating among children. The aim of the program is to fund research that will identify interventioons to prevent childhood obesity among low-income, racial and ethnic populations at highest risk for obesity. Research focuses on areas such as menu labeling, agricultural policy, food marketing and food access to inform the field and key stakeholders. The research, often published in peer-reviewed journal articles, is made available to a wider audience through issue briefs, research highlights, and presentations.

Active Living Research builds the evidence to prevent childhood obesity and support active communities by funding research examining how environments and policies impact physical activity, especially among racial and ethnic minorities and children living in low-income communities. The evidence is used to inform environmental and policy changes that encourage active living for both children and their families. Research comes from scholars in myriad fields – for example, health, planning, transportation, and recreation – who work together to assess the impact of the streets, neighborhoods, and cities in which kids live and play.

What solutions work? In 1973, the second year of its existence, the Foundation funded its first evaluations. These first evaluations, one on the developing emergency medical system and another on the Foundation's medical and dental student aid program, helped the Foundation ascertain the effectiveness of its programs. Today, evaluations continue to help RWJF understand what solutions work. The audiences for evaluations may vary; some are directed to the foundation staff or board members, while others are directed at policy makers or practitioners. Regardless of their audience, evaluations remain an important part of RWJF's grantmaking – all large programs are evaluated by objective, external researchers and several smaller grants require an evaluative component. Evaluation answers questions such as: 1) Are the programs the Foundation is funding accomplishing what they set out to do?

and 2) Are they in line with the Foundation's overall strategy? While research informs the Foundation on how and where to make an investment, evaluation provides a way to garner objective feedback on the impact of its investments.

Cash & Counseling. Cash & Counseling is an effort to provide consumer-directed care for elders and disabled beneficiaries covered by Medicaid. By providing a budget for homebound elders and disabled adults with chronic conditions, Cash & Counseling allows participants to buy the home-health services they need from people of their choice, like a relative, rather than receiving specified services from a Medicaid-approved agency. RWJF and the federal government funded a three-state program experiment. The evaluation conducted by Randall S. Brown and his team at Mathematica Policy Research, Inc. found that Cash & Counseling significantly reduced the unmet needs of Medicaid consumers requiring personal assistance services; improved quality of life for both participants and their caregivers; and did not result in misuse of Medicaid funds. Costs were somewhat higher than those for traditional home health care, but these were partially offset by reductions in nursing home cost and could be controlled in a well-designed program. This evaluation contributed to changes in both federal and state policies. After the results were known twelve additional states replicated the program under Medicaid waivers, and later the Deficit Reduction Act of 2005 allowed states to adopt the approach without a waiver beginning in 2007.

Nurse-Family Partnership. In the 1970s, RWJF supported a demonstration project in Elmira, New York using registered nurses to take preventative health services into the homes of young, low-income pregnant women who were becoming first-time mothers. These visits connected new young mothers to support systems, including social services, while helping them become better parents. Randomized controlled trials from Elmira beginning in 1979, and subsequently Memphis and Denver, showed children and mothers benefiting with positive health and developmental outcomes from home visits. Studies show that improved prenatal health, fewer childhood injuries, fewer subsequent pregnancies, increased intervals between births, increased maternal employment and improved school readiness are consistent program effects. Four decades later, David L. Olds, creator of the intervention, continues to spread the model to other communities. The program serves about 21,000 families today in 32 states. Recently, the Patient Protection and Affordable Care Act of 2010 provided for $1.5 billion in funding to states over five years for evidence-based home visitation. This will allow more states to implement the Nurse-Family Partnership.

Conclusions

Not every project sponsored by RWJF is successful. One of the authors of this article has written elsewhere about programs that didn't work out as expected (Issacs and Colby, 2010). For example, the Study to Understand Prognoses and Preferences for Outcomes and Risks of Treatments (SUPPORT) aimed to improve end-of life care. In this large $31 million research demonstration project, specially trained nurses counseled terminally-ill hospitalized patients and their families. The study showed that the intervention did not improve end of life care in any way! Despite the negative results, SUPPORT provided vital information for the field of palliative care and served as a catalyst for subsequent successful Foundation investments in this area.

As is the case with programs, not every evaluation is successful or well timed. In the mid-1980s, the Foundation funded the AIDS Health Services Program. This program was designed to spread a San Francisco model of care for people with AIDS. The evaluation, published in 1994, provided valuable information on the structure and availability of services and their cost, as well as the impact of case management. Nevertheless, once policy makers saw that the program model could be spread to communities that had different cultures and public health systems than San Francisco, they incorporated it as part of the Ryan White Act in 1990, long before the evaluation results were known.

Measuring the priceless is difficult and, sometimes, researchers are not successful in accomplishing it, but the effort is important. Despite the messiness, difficulties, and outright failures, setting nonfinancial goals and measuring nonfinancial outcomes sharpens the Foundation's social investment strategy. Making the nonfinancial results public improves the Foundation's efforts to take program models to scale by providing evidence to other investors – helping others who have done well to do good. Likewise, measuring the priceless and making those measures public will strengthen the field of community development.

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A Role for the Feds? The Opportunities and Challenges in a Federal Government Role in Measuring and Defining Social Impact in the Impact Investing Field

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The impact investing field has made notable strides in recent years in developing metrics for measuring and evaluating the social impact of its investments. This includes the launch of the Global Impact Investment Rating System (GIIRS), which offers a third-party social and environmental impact assessment of companies and funds resulting in a rating that institutional investors and investment intermediaries can rely on in making investment decisions. It also includes the development of the CDFI Assessment and Rating System (CARS™), which offers both a financial and social performance rating for Community Development Financial Institutions (CDFIs). Both are examples of social performance metrics that have been developed by a coalition of impact investors and impact oriented companies.

However nonfinancial returns are notoriously difficult to quantify, measure, and compare across the many asset classes in which an impact investor may seek to deploy capital. For example, a fund manager may be choosing between investments in an affordable housing fund or a charter school facility. How do they compare the returns from the housing fund to the charter school? Even more difficult, how does the manager make a comparison between two housing investment funds? Purely in terms of the number of units built? On whether they target the poorest? On targeting cities with the highest rental prices? Once an impact investor decides what information to collect, they still must find a way to collect the information. How do investors and their fund managers collect this information in a manner that is cost effective to investors and investees?

This question is especially timely in light of the economic downturn. With shrinking public budgets at the federal, state, and local level, public dollars available to support social services, non-profits and economic development are dwindling. With the economic downturn impacting foundation balance sheets, the grant dollars that traditionally financed these activities are no longer available. More effective measurement of social impact could lead to new investors entering this marketplace and expand the financing of socially beneficial or socially oriented enterprises. It could also help fuel new forms of entrepreneurship and new business models that seek to both make a profit and have a social benefit, a movement that goes by many names including social enterprise, "double bottom line" enterprises, and benefit corporations.

While the impact investing industry continues to tackle these questions of impact measurement, the question naturally arises regarding role the federal government can play in helping support, encourage, or facilitate impact measurement. Some want to look to the federal government as a source of the actual impact measurements. A harmonization of impact measurements is, however, unlikely to come from the Federal government. While the current administration has considered ways for Federal agencies to report publically their performance, starting with the Recovery Act's Recovery Accountability and Transparency Board charged with providing the public with transparency on Recovery Act spending and job creation and continuing with the Office of Management and Budget's High Priority Performance Goals, it is unlikely that the impact investing industry can directly rely on the social performance measures government agencies generate. While the government in some sense acts as an impact investor when it dispenses competitive grants, it is unlikely that the Federal government agencies can harmonize all impact measurements across the agencies. There is variation across and within agencies due to different statutory mandates, regulations, and oversight bodies that drives the performance measures used at each agency and for each program. For example, a financing program run by USDA will attempt to measure geography of the investments to demonstrate rural outreach, while a similar facility run by SBA may focus more on the sector of the investment.

Nonetheless the federal government can still play a constructive role in supporting the impact investing industry's search for social impact metrics.

The impact investing industry can look to the federal government to establish the investment areas that have "impact." The federal government's establishment of policy priorities in particular areas can help impact investors select their at-need populations or the social goals of their interventions. The investors can adopt the targeting criteria used by federal agencies or specific federal programs. The CDFI Fund defines certain population groups or geographic areas as categorically lacking access to capital, offering the impact investor a characteristic to track when investing in CDFIs. The SBA sets thresholds per sector for defining small business, allowing a small business minded impact investor to carefully select investees or measure the ultimate targets of the investment. The federal banking agencies, through the Community Reinvestment Act regulations, define community development. Impact investors can look to government standards as a marker for whether an investment has impact, and provide activities or other markers for investors to track even if the investor still must quantify precisely how much impact the target investment has.

The federal government can serve as an information source. The federal government is a producer and aggregator of large amount of information. The impact investing community could identify key data points that could be collected at the federal level that would help facilitate the measurement of their investments. The data could be used pre-investment, to compare different investment options, or post-investment, to compare the performance of investments. For example, EPA data on environmental violations or Department of Transportation data on carbon emissions can be used to assess a company's green performance.

Government certifications or labels as quality assurance seals. Government can also provide a quality seal to organizations through certifications. This can give the impact investor some assurance that an institution has a mission impact or is achieving a mission goal. A few examples include Treasury's Community Development Financial Institution (CDFI) certification, the Department of Housing and Urban Development's certified counseling agency, and Department of Energy's Clean Cities. This helps decrease the due diligence required pre-investment and may offer some markers for the investor to track, because the investee may already be tracking these markers for government compliance purposes. As the impact investment industry matures, it may consider developing new certifications for federal agencies to administer, and must weigh the costs and benefits of an industry led certification as opposed to a government led one.

The government's role in supporting impact measurement can be more indirect, as well. The voice of the federal government can be a powerful tool to galvanize and spur the private sector into action on issues of concern. In these instances, the federal government does not lead industry by establishing standards or definitions but instead invites the private sector to work further in a particular area. The First Lady's Let's Move! initiative to combat childhood obesity offers an example, helping to encourage the creation of the private sector led Partnership for a Healthier America which will spur action across the private sector to achieve the First Lady's childhood obesity reduction goals.

In the end, the impact investing industry should consider the best way to leverage the federal government into the impact measurement arena. For example, is the industry best supported in its current stage by the federal government promoting impact investing or providing financial incentives to impact investors? Or, conversely, is the industry still in a nascent stage and therefore would prefer more indirect forms of government support, such as use of the federal bully pulpit powers to simply draw attention to the field.

Impact investing is still an emerging sector; accordingly clear definitional parameters have not yet been firmly established, although the excellent work highlighted in this volume indicates that progress to this end has been made. The industry still needs to settle uncertainty surrounding what distinguishes impact investing from the simple measurement of the positive externalities of a business. For example, should the impact investing label be narrowly defined as investments in enterprises that focus on solving a social problem – such as a business that focuses on providing workforce training opportunities to low income individuals – or more broadly defined as businesses that employ good social practice that are incidental to the business – such as a carbon neutral policy that places the company in energy efficient real estate or leads to purchasing of carbon offsets. Or instead, should the definition not focus on the businesses and instead focus on the investor. For example, is an investment in the carbon neutral business an impact investment because the investor was motivated to invest based on that impact?

The federal government offers a diverse array of tools upon which impact investors can already rely to select measurements for impact or to find sources of data on potential investees. There is always the risk that government intervening too early or prematurely will set the standard at a place investors are not comfortable and will not actually enhance capital flows to the sector. Therefore, as the industry matures, it should continue to look for ways federal policy could enhance the efficiencies in the impact investing marketplace, and educate the federal family on the industry's new growth and expanding infrastructure.

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