Increasing Access to Capital:

Could Better Measurement of Social and Environmental Outcomes Entice More Institutional Investment Capital into Underserved Communities?

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The role of capital in promoting growth is more apparent than ever as communities across the country struggle to bolster sagging economies and stem job losses brought on by the credit crunch. Although it may seem now that all markets are undercapitalized, some areas are chronically undercapitalized, including inner-city urban markets, rural markets, low-income communities, and enterprises owned by minorities and women or serving undervalued customer bases. Their struggle for capital means a struggle to thrive, and for owners, entrepreneurs, employees, customers, and communities, whether they will have a chance to reap the benefits of economic opportunity.

In recent years, access to capital for entrepreneurs in underserved markets has grown as institutional investors tap into overlooked investment opportunities in the emerging domestic markets. Institutional investors include public-sector pension funds, foundations, banks, insurance companies, and faith-based organizations. These groups are seeking viable investment opportunities that also spark economic development through more and higher-quality jobs that stimulate local economies; that provide more opportunities for women and minority entrepreneurs; or that benefit the environment.[2]

Institutional investors may refer to this practice as "economically targeted investments," or more broadly "targeted investing," "urban investments," "community-based investments," "mission-oriented investments," "double bottom line investments," or "dual objective investing."[3] Whatever the name, the practice is a specialized type of investing that seeks, first and foremost, risk-adjusted market rates of return for its investors along with a secondary social return.

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2 L. A. Hagerman, G. L. Clark, and T. Hebb, "Investment Intermediaries in Economic Development: Linking Public Pension Funds to Urban Revitalization," Community Development Investment Review. Vol 3 (1) (2007): 45-65.

3 This growing industry is examined in by Flynn et al., in which institutional investors have created more than $6 billion in double bottom line funds nationally between 1998 and 2006. E. Flynn et al. The Double Bottom Line Handbook: A Practitioner's Guide Regional Double Bottom Line Investment Initiatives and Funds (New York: Ford Foundation and Strategic Development Solutions, 2007), available at http://www.sdsgroup.com/dbl-handbook.html.

Research demonstrates that through a rigorous and disciplined targeted investment policy, public-sector pension fund investment in these markets can produce both a financial and social return. [4] In fact, there is growing evidence that activities funded with an eye toward both long-term economic impact and profits have outperformed many purely profit-motivated activities in the same space. Perhaps the most telling example lies at the root of the current crisis, in the mortgage market. Banks' mortgage lending activities that were required by regulation (via the Community Reinvestment Act [CRA] of 1977) to serve low- and moderate-income communities were much less likely to be unsustainable, subprime loans, and have defaulted at substantially lower rates than the mostly non-CRA portions of the mortgage market. Indeed, targeted investing presents potentially significant opportunity to achieve both financial profits and external, social benefits. Yet for these benefits to be realized, the field needs a more rigorous and standardized method of measuring the social benefits.

The field has reasonably accurate measures of the financial performance of an investment. Environmental investments are also increasingly measured with broadly accepted standards. However, measuring and explaining the social benefit of an investment is still in its infancy. Although the chorus is growing for measuring social outcomes, there is still no agreed on industry standard. Investors are committing significant amounts of capital to "double bottom line" investment. Consider CalPERS' second $550 million commitment in 2007 to the California Initiative that is investing in California's underserved markets. However, we believe these amounts could be much greater if there were a way to more clearly measure the good that came from these investments. With such a measure, more capital would flow to that activity.

In this article, we argue that investments attract capital when reliable measurement standards can be applied across different investments.[5] We also argue that incorporating nonfinancial standards in the investment decision process (while still prioritizing financial return) can lead not only to better social outcomes, but also to better financial returns. Instead of being viewed as a tradeoff, there could be a reinforcing effect.

Transparency in social and environmental returns is essential for investors to make informed decisions on their current and future investments in these markets. With transparency, investors can share information to better understand the right questions that lead to both financial and social investment results. In this article, we examine other ratings systems for seemingly different investments that have led to greater investment flows. We offer these examples to explore whether a better, more rigorous system could lead to greater invest-

4 The 2008 Pension Funds and Urban Revitalization Initiative developed research in this area. See http://urban.ouce.ox.ac.uk. The research estimated that as of 2007, there are approximately $11 billion of public-sector pension fund commitments (across all asset classes) in urban revitalization, emerging domestic markets, or more broadly, economic development, through either formal targeted investment policies or one-off investments. See Hagerman, Clark, and Hebb, "Investment Intermediaries in Economic Development."

5 This article is a shortened version of working paper completed in July 2008 and can be found at: http://www.frbsf.org/publications/community/wpapers/index.html.

ment in the underserved private equity sector. After considering what investors want from social impact metrics, we close with some recommendations about future directions.

Comparing Apples to Apples: Ratings Systems Serve as a Tool for Investors

The Rise of Conventional Credit Rating Agencies

The 1837 financial crisis underscored the need for the service of providing credit history on a business or individual. Louis Tappan, Robert Dunn, and John Bradstreet developed credit rating agencies in the 1840s and 1850s that would later consolidate to form Dunn and Bradstreet.[6] John Moody, a former Wall Street analyst and errand runner, expanded the options in 1909 with his ratings of U.S. railroad bonds. By 1924, Moody's Investors Services covered nearly the entire bond market. Today, Moody's is one of "The Big Three" international credit rating agencies, along with Standard & Poor's and Fitch Ratings. This innovation allowed investors to compare "seemingly incomparable" investments using a simple grade of risk (AAA, AA, A, etc.). With this information, an investor with a given risk tolerance could better evaluate the quality of the potential investment and make more informed investment choices.

Environmental Performance Indicators

The emergence of environmental performance indicators has come about partly because of the commitment of well-established organizations. Ceres (Coalition for Environmentally Responsible Economics) and the United Nations Environment Programme (UNEP) partnered to spearhead the Global Reporting Initiative (GRI). GRI is the first global framework for comprehensive sustainability reporting by corporations, governments, and nongovernmental organizations on economic, environmental, and human rights issues.

The International Organization for Standardization (ISO) is an international network that sets standards, including "generic management system standards" such as the well-known ISO 9000 family (universally accepted quality standards in manufacturing). It has introduced the ISO 14000/14001 Environmental Management Systems (EMS) to provide a framework to implement processes to meet environmental goals.

The U.S. Green Building Council is the source of the Leadership in Energy and Environmental Design (LEED) rating system introduced as recently as 1998 and now used widely. These standards certify if a building project is environmentally friendly. The standards are based on a series of credits for sustainability of construction sites, water efficiency, renewable energy, recyclable materials, and indoor environmental quality, among other factors. Harkening back to the straightforward grading system of the credit rating agency, the LEED process awards certification levels ranging from certified, silver, and gold, to platinum. A comparison of buildings certified by LEED and Energy Star with comparable nongreen properties found that the environmentally certified properties performed better on a number of

6 R. Cantor and F. Packer, "The Credit Rating Industry," Journal of Fixed Income 5 (3) (1995): 10-34; and "The Crating Rating Industry," Federal Reserve Bank of New York Quarterly Review (Summer/Fall 1994): 1-26.

economic indicators, including energy costs, occupancy rates, sales prices and rental rates.[7] Real estate professors Gary Pivo and Jeffrey D. Fisher find that Energy Star energy-efficient buildings performed slightly better than noncertified properties as a result of lower utility costs. The study concluded that responsible property investments were no less safe than traditional investments and that investors can be socially responsible while also earning competitive financial returns.[8]

Several rating agencies are seeking to make the correlation between environmental, social, and governance (ESG) performance and financial performance. For-profit organizations such as KLD Research and Analytics screen companies on social performance using ESG indices that investors can integrate in their investment decisions. KLD maintains the database Socrates, which measures the social and environmental performance of corporations and allows investors to screen portfolios and track shareholder resolutions. Ratings of Innovest Strategic Value Advisors (now Risk Metrics) have been used to show that incorporating ESG factors into the investment decision-making process can enhance portfolio financial returns and identifies nontraditional sources of risk potential for investors.[9] Other agencies, such as Trucost Plc, help companies and investors measure and reduce their environmental impact, and understand how environmental performance correlates with the financial performance of portfolio companies. Trucost's "Carbon Footprint Analysis" has several components, such as calculating the carbon performance (expressed in financial terms) of each company in an investor's portfolio, and compares the fund's carbon costs against its benchmark.

Although the ratings issue is complex, turning something that is socially valuable into a financial structure is a means to attract new investors who need such instruments for a potential investment. Organizations modeled after Doctors Without Borders in the community development finance industry (in this case Wall Street Without Walls) have been able to do this. Wall Street Without Walls assisted the Community Reinvestment Fund (a large community development loan fund in Minneapolis) with the structure and process of getting a AAA/AA rating from S&P on a $52 million pool of economic development loans. The process allowed for six new insurance companies to enter the market of socially responsible investments.

7 U.S. Green Building Council, "Newly Released Studies Confirm Energy Savings Significant in LEED, ENERGY STAR Buildings; Certified Buildings Outperform Peers in Sale, Rental, and Occupancy Rates." News release, April 3, 2008, Washington, DC.

8 G. Pivo and J. Fisher, "Investment Returns from Responsible Property Investments: Energy Efficient, Transit-oriented and Urban Regeneration Office Properties in the U.S. from 1998-2008." Working paper. (Boston: Responsible Property Investing Center, Boston College and University of Arizona, and Benecki Center for Real Estate Studies, Indiana University, October 2008, rev. March 2009).

9 Innovest Strategic Value Advisors, Innovest Strategic Value Advisors & the United Nations Principles for Responsible Investment (New York: Innovest, January 2007), available at www.innovestgroup.com.

Community Reinvestment Act Ratings Align Social Objectives with Safety and Soundness

For driving socially responsible investments, one of the more established devices in the United States is the Community Reinvestment Act of 1977 (CRA), which sought to increase bank financing in low-income and minority neighborhoods. The CRA is based on the premise that banks must serve the credit needs of the entire community–including low- and moderate-income areas–in markets in which they are chartered and take deposits. In addition, the CRA states that banks must accomplish this "consistent with the safe and sound operation of such institutions."[10]

Federal regulatory agencies conduct CRA evaluations.[11] CRA ratings range from "substantial noncompliance" to "needs to improve" to "satisfactory" to "outstanding," and can determine whether banks receive permission to merge or expand. The ratings are also made public, and they can influence an institution's reputation. It is generally agreed that the CRA has substantially increased investment in low- and moderate-income communities. For instance, the Federal Financial Institutions Examination Council finds that in 2006, lenders in conjunction with CRA-eligible practices either originated or bought $56 billion in community development loans, $306 billion in small business loans, and $12.5 billion in small farm loans. Mortgage data indicate substantial increases in lending to low- and moderate-income and minority communities attributable to the CRA, particularly after the lending measurements became more quantitative and less subjective in the mid-1990s.

The CRA provides further evidence that widely accepted social performance standards can attract capital. What is also clear is that, like the LEED environmental certification, activities that score high on social goals are good financial bets. The vast majority of institutions report that their CRA activities are profitable.[12] Several recent studies comparing CRA-covered mortgages and institutions with nonregulated mortgages and lenders find that few CRA-covered mortgages were subprime or "high-cost," that is, of the type significantly more likely to default.[13]

10 G. Smith, M. Bush, and N. Paufve, "Measuring the Provision of Banking Services for the Underbanked: Recommendations for a More Effective Community Reinvestment Act Service Test," Woodstock Institute Reinvestment Alert, 31 (2007): 1-10.

11 Depending on the type of depository institution, the regulatory agency conducting the CRA examine could be one of the following: the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, or the Federal Reserve Board.

12 M. S. Barr, "Credit Where It Counts: The Community Reinvestment Act and Its Critics," New York University Law Review 13 (6) (2005): 515-651.

13 Elizabeth Laderman and Carolina Reid, "CRA Lending During the Subprime Meltdown," Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act (Boston and San Francisco: Federal Reserve Banks of Boston and San Francisco, 2009); Lei Ding, Roberto Quercia, Wei Li, and Janneke Ratcliffe, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Scoring Models." Working paper (Chapel Hill, NC: UNC Center for Community Capital, 2008), available at http://www.ccc.unc.edu.

Advancing Social Metrics Is Vital to the Industry

The targeted investing industry is growing as banks, insurance companies, public pension funds, foundations, and faith-based organizations are strategically focusing on investments that produce financial and societal returns. However, the issue of how to measure quality and success remains a central component to the development, and even the basic definition, of the industry. As such, the field must devise methods to ensure delivery of both financial and social returns. As LEED and CRA standards show, improved measures of the social returns can facilitate increased capital to the underserved markets. Such a social return is also evident in the CalPERS example, in which pension fund officers considered the social returns on the first California Initiative commitment of $475 million in determining whether to make a second California Initiative commitment of $550 million.[14] The question now is, how does the industry collectively transform the field through clearer social objectives and measurement standards?

Investors are always seeking data on their investments. The more institutional investors know about a potential investment's risk and return, the more readily they can make sound investment decisions.[15] Currently, investors are able to compare the financial returns using established financial benchmarks such as the "Property Index," created by the National Council of Real Estate Investment Fiduciaries for equity real estate, or the Thompson Reuters' "Private Equity Index" for venture capital, and "Barclays Capital Aggregate Bond Index" for fixed income products.

Likewise, the types of social investors and the way in which they monitor social returns will vary in line with their specific motivation for investing in underserved markets. A bank, public-sector pension fund, insurance company, foundation, or faith-based organization, each places a different value on the importance of measuring the social returns on their investment. The following four sections examine the questions four of these different investors ask in selecting investments on the basis of social returns (as identified in Table 2). The sections also examine investor motivations for seeking social returns, whether they be part of a policy, program, or in response to regulatory supervision.

Banks: Showing Leadership in Community Investing

Banks have a long history of double bottom line investing and lending arising from their CRA obligations. Under CRA, the largest institutions (those with more than $1.061 billion in assets) are subject to three tests: lending, services, and of particular interest to our subject, an investment test that considers investments that have community development as their primary purpose (within qualifying geographic areas). Although this is a broad definition,

14 Pacific Community Ventures provides analyses on social returns that measure outcomes such as job quality (e.g., wages, benefits, wealth building) green jobs, and capital flows to the underserved markets.

15 Hagerman and Hebb, "Balancing Risk and Return in Urban Investing" In "Managing Financial Risks: From Local to Global" EDS, Clark G., A. Dixon and A. Monk. Oxford University Press.

certain activities are automatically qualified, such as investments in Small Business Investment Companies (SBICs) and New Markets Tax Credits.

Discussions with representatives of large banks confirm the importance of CRA in driving financing of activities alternatively referred to as "underserved communities," "double bottom line," "community development investing," or more explicitly, "CRA investing." In general, institutions develop CRA plans with high-level geographic- and dollar-based objectives. Although different banks systematize their CRA investment allocation in different ways, institutions commonly divide their allocation between qualified housing investments and those available for other activities. The latter may include private equity for commercial real estate; private equity for business enterprises; investments in Community Development Venture Capital firms and SBICs; loans, deposits, program related investments or PRIs, or near-equity investments in nonprofit financial institutions; and historic and new markets tax credits. In short, they represent a variety of nontraditional financing activities. Proposed investments must meet the CRA criteria to "get in the room" for consideration.

Banks have generally no standardized protocols for measuring social benefits beyond what goes into CRA compliance. That is to say though they may gather information on job creation, job quality, sociodemographics of investees, direct and indirect benefits of a development, and so forth, it is not systematically collected, evaluated, tracked, reported, or benchmarked. Reasons for lacking such a system include the fact that CRA credit outweighs other considerations; varied investment types give rise to different pathways for social impacts; the subjectivity of social benefits; the lack of independently verifiable and auditable data; and costs in both time and money to collect robust information. Nevertheless, in the CRA banking community, there is interest in enhanced social metrics, particularly for upfront investment selection, clarifying and supporting an investment "theme," streamlining due diligence, and facilitating benchmarking. Thus, enhanced social metrics would make it easier to evaluate investments vis-á-vis hurdle rates or alternatives, however, it is doubtful that even the most rigorously verified social impacts would ever result in financial return tradeoffs.

In a different model, BAML Capital Access Funds (BAMLCAF), a division of Bank of America, makes private equity investments on behalf of public pension fund investors in funds seeking to invest in underserved businesses.

Although the bank co-invests a portion of its own capital, CRA is not a focus for the BAMLCAF, which operates within the bank's private equity division. The bank worked with its lead investors (CalPERS and CalSTRS) to develop a system for collecting data on social outcomes. Through a requirement in the side letter to the upfront investment agreement with each fund, the funds for each portfolio company report this information.

With funding from the Kauffman Foundation, the University of North Carolina Center for Community Capital manages and analyzes the data and coordinates with Bank of America in producing annual progress reports.

As of March 31, 2009, BAMLCAF has committed nearly $309 million to 25 private equity and venture capital funds, which, by the end of 2007, had invested in nearly 120 companies. Seventy percent of these companies meet one or more of the funds' criteria for being underserved, including about one-third that are minority led, and approximately one-third that are located in low- and moderate-income census tracts. The average portfolio company employs 330 people.

Although there is no such thing as a "typical" investment, the various portfolio companies can be generally characterized as not fitting the mold of the traditional venture capital investment; that is, they are rarely found in Silicon Valley, and they range from traditional manufacturers to banks to entertainment to food service. For example, a BAMLCAF investment in a Mississippi-based manufacturer of healthy, rehydration beverages for industrial workers enabled this company to fund new equipment and expand into new markets, including internationally. Today the company employs more than 50 workers, with a full benefits package including health insurance, a 401(k) program with a match, and opportunities for advancement and on-the-job training.

More recently, BAML Capital Access Funds was selected by the New York Common Retirement Fund to manage a fund of funds focused on private equity managers who are female or ethnic minorities.

In venture capital investments, the early financial returns are often very low or negative owing to the "J-Curve effect," when funds have not yet exited on the investment and are absorbing high management fees.[16] CalPERS, one of the more transparent pension funds in their reporting, posts returns on its Alternative Investment Management Program, which includes the California Initiative. Since inception, the return on the California Initiative Fund I was 20 percent (as of 2007), with a one-year return of 70 percent (as of October 2007).[17] We now turn our attention to MassPRIM's economically targeted investments and their impact on the Commonwealth of Massachusetts.

Public Pension Funds: MassPRIM's Social Returns on Targeted Investments

MassPRIM, the Massachusetts Pension Reserves Investment Management Board, targeted investments cross the asset classes of fixed income, equity real estate, and venture capital. The investments target 2 percent of its total assets ($50.6 billion as of June 30, 2008). MassPRIM has committed $230 million to Economically Targeted Investments (ETI) since the program's inception in 2003. The firm allocates these commitments across three asset classes and nine investment managers. Table 1 details how well each individual investment fund manager is performing on the social returns in terms of mortgages created, jobs created, affordable rental housing units, and small business or economic development loans.

16 T. Hebb, "California Case Study A: Private Equity CalPERS' California Initiative" Working paper 05-15. 1-28. (New York: Oxford University Centre for the Environment, 2005).

17 J. Mark, "CalPERS Alternative Investment Management Program: Investing in California's Underserved Markets." Power Point presentation to Inner City Economic Forum Summit, Philadelphia, October 18, 2007.

Table 1. MassPRIM ETI Program's Impact on the Commonwealth of Massachusetts as of March 31, 2009

Firm	Asset Class	Mortgages	Jobs Created	Affordable Rental Housing Units	Small Business/ Economic Development Loans
Access Capital	Fixed Income	1311	300	201	13
Community Capital Management	Fixed Income	98	23	2200	2
AFL-CIO HIT Fund	Fixed Income	18	484	1155	0
Castille Ventures	Private Equity	0	85	0	0
Flagship Ventures 2004	Private Equity	0	498	0	0
Flagship Ventures 2007	Private Equity	0	79	0	0
Canyon Johnson	Real Estate	0	270	15	0
New Boston	Real Estate	0	360	0	0
Intercontinental	Real Estate	0	385	20	0
Total		**1427**	**2484**	**3591**	**15**

Source: MassPRIM Executive Office, ETI Program Summary 1st Quarter 2009, page 2.

The ETI first quarter summary report notes, "While each of the three asset classes in our ETI program has a different time horizon, the overall ETI program is meeting expectations. As the Board is aware, due to the nature of both Real Estate and Private Equity investing, the full benefits to the Commonwealth of Massachusetts will not be fully realized for several years. That said, it is estimated that over 1,400 mortgages, 3,500 affordable rental housing units, 2,400 jobs, and 15 small business/economic development loans have been, or will be, created across all three assets classes."[18]

MassPRIM requires external fund managers to deliver and report on the basic social returns in quarterly reports. For selection, fund managers take part in a rigorous "request for proposal (RFP)" process that identifies a manager's ability to invest in the underserved markets and perform on both the financial and social returns (see Table 2). The reports provide an initial snapshot of how fund managers are performing on the ancillary benefits. In the case of Access Capital, a fixed-income asset manager, the fund provides more detailed reporting modeled after CRA guidelines. Pension funds find the reporting straightforward. In Access Capital's case, as of March 31, 2009, their program created 1,300 mortgages, 300 jobs, 200 affordable housing units, and 13 small business economic development loans.

18 MassPRIM Executive Office, ETI Program Summary 1st Quarter 2009, page 1.

Foundations and Insurance Companies: Supporting Their Missions and Improving Quality of Life

A growing number of foundations are also leaders in targeted investing, or as they call it, "mission investing."[19] The Annie E. Casey Foundation established a formal "Social Investment Program" in 2002, and in 2004, the trustees allocated $100 million (approximately 3 percent of the endowment) to social investments to benefit both the foundation's endowment and its programmatic activities. The F.B. Heron Foundation, a leader in mission investing, commits 35 percent of its endowment to mission investing (as of year-end 2008). It intends to increase this share to 50 percent by the end of 2009. Both foundations specify their social objectives, in line with programmatic interests, and rigorously track the social returns (see Table 2).

Insurance companies engage in targeted investing as well. Metlife's social investment program improves quality of life through housing, education, economic and community development through investments. They request financial reporting of their fund managers as well as reporting on the ancillary benefits that detail basic social impacts.

Toward a Unified Measure of Social Value

Each of these investors places a value on the social returns, yet perceives social value from a different perspective. The value allocated depends on the overall objective of the investor's targeted investment policy. Table 2 offers a snapshot of the issues important to institutional investors, categorized by investor type, objectives, and key questions on potential social returns. Investors may have differing social objectives, yet they universally would like to see better metrics. Although there is still a lack of convergence, the field is making progress.

Providing Social Metrics

A growing number of service providers, academic centers, and trade associations are working to develop measures of social and environmental outcomes (see Table 3).

The Community Development Venture Capital Alliance, a trade association, moved the industry a step forward by creating a toolkit of standards for measuring social benefits. The toolkit features a social metrics template for venture capital firms. The Opportunity Finance Network, which supports the Community Development Financial Institutions (CDFI) industry, created the CDFI Assessment and Rating System (CARS). Independent, third-party ratings of CDFIs are performed that are specifically geared to "current and prospective investors and donors in CDFIs." Financial strength is rated on a scale of one to five, while "impact

19 Mission investing seeks opportunities to align a foundation's financial investments with the mission of the organization, while maintaining long-term targeted financial returns. At its core, investor intent drives mission investing, and it focuses on the dual objectives of furthering programmatic goals and earning financial returns. The term "mission investing" covers market rate investments that support program goals; and program related investments structured to create specific program benefits while earning a below-market return. The Boston College "More for Mission Campaign" includes a leadership committee (40 foundations, representing $27 billion in assets) that are committed to mission investing. See http://www.moreformission.org for more information.

Table 2. The Investment Decision-Making Process and Social Reporting Guidelines

Source: Hagerman: Based on data in 2008 ETI RFPs, MassPRIM, NYCERS, Vermont State Retirement System, senior staff (Spring 2008).

InvestorType/ Examples	**Objectives**	**RFP questions relevant to targeted performance on social returns or Key impacts identified in the investor's social investment guidelines**	**Reporting**
Pension Funds: MassPRIM (www.mapension.com)	Economic development in the state of Massachusetts.	1. Demonstrate that your investments will target a "capital gap" where there are likely to be underserved markets. 2. Demonstrate that your firm is capable of tracking investment performance and the collateral benefits of your investments. 3. Demonstrate that your firm will invest over 50% of PRIM's investment in the portfolio in the Commonwealth of Massachusetts. 4. What unique attributes does your firm or your product have which distinguish it from its competitors in the fulfillment of this assignment? 5. Describe how your product differentiates itself from those of PRIM's current managers. What role would your portfolio play in PRIM's ETI Program?	Quarterly report detailing financial and social returns
Pension Funds: NYCERS (www.comptroller.nyc.gov)	Fill capital gaps in New York City; i.e. offer financing in areas that are underserved by existing market mechanisms. The 2008 RFP, was originally issued in May 2003, has been amended and re-issued to solicit equity-based investment proposals in addition to debt-based proposals.	Proposed Impact on low-moderate and middle income neighborhoods and populations or women and minority populations in New York City must be detailed. RFP asks potential firm to describe the marketing plan and how the fund manager will source product asking: Will this program differentiate itself from others in this market? What is the value added to this market by a pension fund economically targeted investment? The Comptroller's Office and systems also notes they want to see City business opportunities available to firms with strong Equal Employment Opportunity progams, including those with significant woman and minority-ownerships. Describe the potential collateral benefits for NYC. Specify (and quantify to the extent possible) the demographic or economic sector expected to benefit. Identify any collateral costs (e.g. sectors or population groups likely to be disadvantaged by selection of the proposal). Describe your lending or investment experience in low-moderate or middle-income neighborhoods or individuals, including experience in residential lending (multifamily, single family), commercial lending (real estate, business loans etc.) and community facility lending.	Managers must provide reports on a regular basis. The content and timing of the reports will be determined by the particular features of the program(s) established via the RFP and may include monthly and/or quarterly reports.

Table 2, continued

Pension Funds: Vermont Pension Investment Committee (www.vermontreasurer.gov)	Fill capital gaps in Vermont; offer financing not currently available through existing mechanisms.	Provide specific quantitative and/or qualitative economic benefits to the state of Vermont. Proposals must identify the capital gap to be filled, the sector of the market that is not efficiently served by lenders, or investors, and clearly demonstrate the collateral benefits to the State of Vermont. Investments must provide collateral economic benefits that enhance quality of life and promote economic development and activity to the targeted area -- Vermont. Collateral benefits may be quantitative (e.g. the investment results in additional affordable public housing units produced) or qualitative (e.g. the investment results in improved public facilities or environmental benefits). Identification of capital gaps includes for example: Low to moderate income quality housing investment: funding for managed mortgage programs suitable for first time and other underserved borrowers; entities lending to affordable housing projects. Loans or equity capital funding for small to medium size businesses: Venture Capital, Mezzanine Debt Funds; debt and equity expansion capital; SBIC lending programs and purchase of SBA, loans other lending or investing to promote the expansion of environmentally attractive business technology and environmental engineering.	The quality of controls and reporting systems (including audited financials, risk management systems and reports to investors); must be submitted in RFP process and set forth once selected.
Foundations: Annie E. Casey Foundation (www.aecf.org)	Foundation's mission is "place-based" in that the foundation supports comprehensive strategies in specific neighborhoods and communities. Seeks to strengthen support services, social networks, physical infrastructure, employment, self-determination, and economic vitality in distressed communities.	Across the three types of investments (Mission-Related Deposits, Program Related Investments, and Mission-Related Investments) the Annie E. Casey Foundation Social Investment Program measures the impact of its investments on two levels as noted in their program guidelines: 1. Population-level impact focus on community-wide improvements. These can include increased access to services, reductions in poverty, public policy that responds to the needs of families, improved infrastructure, increases in jobs, homeownership, earnings etc. In many cases, the Foundation partners with research institutions to collect objective data on macro-level outcomes in targeted neighborhoods. 2. Deal-specific impact is written into the covenants of individual investment agreements. These are established on a case-by-case basis, depending on the investee organization's competencies and include quantifiable targets, such as specific numbers of affordable housing units developed, small businesses financed, jobs created etc. These impacts are measured on an ongoing basis as part of each organization's reporting requirements.	Reports vary depending on investment and as requested by Foundation.

Table 2, continued

Foundations: F. B. Heron Foundation (www.fbheron.org)	Promote one or more of the following "wealth-creation" strategies for low-income families and communities: advancing home ownership, supporting enterprise development; increasing access to capital; and reducing barriers to full participation in the economy by providing quality child care.	Mission-related investments may take the following forms as noted in their website guidelines: -Program-related investments, typically low-interest senior or subordinated loans or equity-like investments to nonprofit or for-profit organizations whose work closely corresponds with the Foundation's programmatic interests; -Market-rate insured deposits in low-income designated credit unions or community development banks; -Other mission-related investments including, but not limited to, private equity and fixed-income securities offering a risk-adjusted market rate of return with substantial social benefits to low-income families and communities. When reviewing a potential mission-related investment, foundation staff conduct a comprehensive review of the prospective investee's program achievements, governance, management and program competencies, financial health, and future plans in order to judge its ability to meet the terms of the investment. The foundation notes that as is the case with any investor, the Foundation will balance the risks of a given investment against its potential financial and social returns. The foundation makes investments across three wealth creation strategies that best support their mission and seek social impacts across these three strategies: Home Ownership (Advancing home ownership in low and moderate-income communities), Enterprise Development (Supporting enterprise development in distressed communities) and Access to Capital (Increasing access to capital and preserving assets for low-income families and communities).	Reports vary depending on investment and as requested by Foundation.
Insurance Company: MetLife	Seeking market-rate investments to benefit community and opportunity, unlike banks no CRA like legislation imposed.	Guideline that governs investments with language to the extent of, " The officers of Metlife can make community development investments to the extent that they benefit economic vitality, education, and minority and women-owned enterprises."	Reporting to Board two times a year that includes social impacts. Also reports to the state trade association, the Life Insurance Council of New York, Inc. (LICONY)
Banks	Revitalize underserved areas in markets where they lend in compliance with the Community Reinvestment Act.	CRA ratings from outstanding to noncompliance based on factors such as borrowers of income levels and by geography.	As determined by CRA reporting guidelines.

performance" is rated on a scale of AAA to B, on the basis of the CDFI's effectiveness in meeting its mission goals.

Specialized investment vehicles are also creating new metrics and reporting products. The National Community Investment Fund (NCIF) has developed a methodology for identifying depository institutions that have a community development mission. NCIF coined the term "community development banking institutions" (CDBIs) for financial institutions that have a community development mission and generate sound financial returns. The NCIF "social performance metrics" assists investors in the investment decision-making process by helping them identify banks with a high proportion of home lending to low- to moderate-income communities (development lending intensity) and institutions that are targeting a significant share of their branches to these areas (development deposit intensity).[20] Pacific Community Ventures, a nonprofit dedicated to developing and investing in businesses providing economic gains to low/moderate income communities in California, provides analyses on social returns that measure outcomes such as job quality (e.g., wages, benefits, wealth building), green jobs, and capital flows to the underserved markets. Building on their experience in documenting the social returns of their own activities, they perform third party evaluation of social returns on private equity investments, including an annual evaluation of the community outcomes of CalPERS' California Initiative private equity portfolio.[21]

Academic centers are a growing resource center for advancing the field. On the venture capital side, as mentioned previously, the Center for Community Capital at the University of North Carolina at Chapel Hill collaborates with the Banc of America Merrill Lynch Capital Access fund-of-funds (BAMLCAF) to collect and evaluate social metrics. The Center for Business and Economic Research at the Louisiana State University, Shreveport, is also attempting to measure impact on venture capital investments.

Among real estate organizations, the Boston College Responsible Property Investing Center (RPIC), sponsored by the Boston College Institute for Responsible Investment, offers resources for responsible property investors. The center, under the leadership of David Wood and in collaboration with the University of Arizona, brings together real estate developers, lenders, fund managers, and investors to share practices, take part in research, and foster professional networking. Social and environmental returns in real estate include affordable and workforce housing, energy efficiency, fair labor standards, smart growth, brownfield redevelopment, and others. Metrics may include figures such as housing units created, incorporation of LEED standards for new construction, Energy Star benchmarking, or distance from public transit centers.

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20 Saurabh Narain and J. Schmidt, "NCIF Social Performance Metrics: A Quantitative Approach to Measuring the Social Impact of Banks and Thrifts, and to Investing Capital in the Community Development Banking Sector" (Chicago: National Community Investment Fund, 2008).

21 See *Pacific Community Ventures, "Executive Summary of Social Return on Investment" and "CalPERS' California Initiative—Impacting California's Underserved Communities*", available via http://www.pacificcommunityventures.org/insight/.

The field is growing quickly with initiatives such as the Rockefeller Foundation's Impact Investing Collaborative (RIIC), which seeks to build a system to promote the flow of impact investment into broader areas of public interest through, for example, the Global Impact Investing Network (GIIN). In addition, the Global Impact Investing Ratings System (GIIRS) aims to assess social and environmental impacts of companies and investment portfolios with ratings similar to the conventional credit risk ratings described earlier of Moody's and S&P. GIIRS will rate the impact of sustainability and mission-focused venture capital and private equity funds. Another initiative is IRIS that aims to set a common framework for defining, tracking, and reporting the performance of impact capital. The development of the IRIS taxonomy is being led by B-Lab, the Acumen Fund, and the Rockefeller Foundation. RIIC has supported research and publications such as "Investing for Impact" and the "Catalog of Approaches to Impact Measurement."[22] The latter catalogs different impact measurement systems (classified as ratings, assessment, and management). Examples include ratings systems such as LEED; assessment systems such as Pacific Community Ventures Social Return on Investment; and environmental impact management systems such as Trucost.

More traditional investment consultants are also emerging to assess potential mission-related investments for their foundation clients. In February 2008, Cambridge Associates announced the formation of the Mission Investing Group with their foundation partners, the Annie E. Casey Foundation, the F.B. Heron Foundation, and Meyer Memorial Trust. This development exemplifies how rapidly the field is growing, with traditional investment consultants now engaged in seeking social impact investments.

In summary, in response to investor demand for evidence of the social benefits from targeted investing, advisory firms, university research centers and trade associations have begun to create tools and services. While these innovations are promising, the field is far from converging on consistent measurement standards.

Moving Forward: Challenges and Recommendations

Although there is value in capturing the social returns of targeted investments, financial returns remain first and foremost for investors. In many respects, measuring social impact is a chicken and egg dilemma. Improved and more widespread social impact measurement will only develop to the extent investors require it. However, investor interest hinges on developing a more clearly defined and measurable investment theme. The environmental field is further along in creating benchmarks and standards metrics, with nationally recognized

22 See Monitor Institute, "Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry" (Cambridge, MA: Monitor Institute, January 2009), available at http://www.monitorinstitute.com/impactinvesting/index.html; S. Olsen, B. Galimidi, and Social Venture Technology Group, Catalog of Approaches to Impact Measurement, Assessing Social Impact in Private Ventures (Version 1.1) (New York: Rockefeller Foundation Impact Investing Collaborative, May 2008), available at www.svtgroup.net/pdfs/RIICcatalog.

Table 3. Types of organizations providing social metrics
Source: Firm websites, senior staff (Spring 2008)

Type of Organization/ Examples	Venture Capital	Real Estate	Debt — Housing, Community Loans	Measures Social & Green Returns	Measures Financial Return	Example Client & Objectives
Nonprofit Advisory Services Provider: Pacific Community Ventures	X			X	X	Varies by investor. Pension fund client example: CalPERS: Objective 1: Providing Capital to areas that have historically had limited access to institutional equity capital Objective 2: Employing workers living in economically disadvantage areas Objective 3: Supporting woman and minority entrepreneurs and managers (PCV/ CalPERS, 2007).
Nonprofit Advisory Services Provider: SJF Advisory Services	X			X		Partnerships with foundations that request detailed reporting based on their programmatic directives (see table 1) outcomes/impacts evaluated includes: employee benefits -- health benefits, wealth creation benefits -- stock options plans, women and minority ownership, training towards homeownership, educational programs -- workforce innovation, cleantech innovation, and amount of additional investment leveraged.
Nonprofit Advisory Service Provider: Coastal Enterprises Inc. (CEI)	X		X	X	X	Foundations: CEI in collaboration with Shorebank Enterprise Cascadia and nine CDFIs created a triple bottom line scorecard. CEI measures outcomes through an "EcoTag Environmental Agreement" includes incentives such as a reduced rate on loans as a reward for a high environmental score such as reductions in energy consumption and green house gas emissions.
For-profit fund manager: Access Capital			X	X	X	Banks: serving low and moderate income communities that receive CRA credit. Pension Funds: broadly targeted investment and like CRA modeled social reporting on returns.

Table 3, continued

Academic Center: UNC-Chapel Hill, Center for Community Capital	X			X	X	Kauffmann Foundation/BACAF example: Companies owned by women and minorities, located in/employing residents of LMI areas with limited access to capital, serving minority markets.
Academic Center: Boston College Responsible Property Investing Center		X		X	X	Resource center providing real estate metrics for industry covering for example: energy-efficient building management, incorporation of LEED standards for new construction, Energy Star benchmarking, transit-oriented development, work force housing, and land conservation.
Specialized Consultants and For-profit Fund Managers in Triple Bottom Line Industry reporting on social returns: Bay Area Family of Funds, CEI Ventures, Cherokee Investment Advisors, Double Bottom Line Investors, Economic Innovation International, Enterprise Community Partners, Imprint Capital, Strategic Development Solutions (SDS), SJF Ventures, USA Fund.	X	X		X	X	Banks, insurance companies, foundations, pension fund, faith based pension funds. Varies by client and mission.

Table 3, continued

Trade Associations: Community Development Venture Capital Alliance, Opportunity Finance Network (CDP Project), Wall Street Without Walls.	X		X	X	X	Focus on mission of serving low to moderate income areas and financing woman and minority owned firms.
Government: Community Development Financial Institutions (CDFIs)	X		X	X	X	Focus on mission of serving low to moderate income areas and financing woman and minority owned firms. Receive CRA credit.
Individual investors: Public pension funds, labor pension funds, church pension funds, foundations, banks, insurance companies.	X	X	X	X	X	Varies by investor, mission, and dedicated staff (e.g. serving low-moderate income employees, environmental goals, promotion of woman & minority enterprises, property investments that support union labor, targeted investments in state, see table 1.) Banks (CRA credit). Insurance companies reporting to LICONY.

benchmarks such as LEED, for example. Their advances are perhaps owing to the clear and direct correlation between quality environmental management and better financial performance on the first bottom line. Metrics on the social returns are less straightforward, yet the correlation between the financial and the social can be made evident, as we have seen in some cases. Among economic development metrics, CRA demonstrates how social benefits can be linked with financial objectives, via the safety and soundness mandate.

In considering how to increase capital flows to the underserved markets, we highlight some of the central questions and issues from an investor's perspective. Four major challenges lie ahead for the industry. First, some fund managers may resist social return reporting owing to confidentiality concerns and the additional work involved. Second, reporting by fund managers raises questions of data accuracy and potential bias in reporting. Third, practical matters arise, including who pays for the evaluations, frequency of reporting, and so forth. Fourth, standardizing analysis is a challenge. On the one hand, investments are varied and are not created equal in their social impacts. On the other hand, investor interests are also divergent; that is, everybody wants customized social outcomes measurements. The question for the industry is how to realize the value from the information through meaningful benchmarks and the practicality of creating standards.

Despite these challenges, institutional investors we interviewed for this research expressed a shared desire for improved indicators of the social returns of investments. As one interviewee said, "Difficulty in measuring is not an excuse to not ever measure." The applications envisioned for such indicators were of a practical nature. They expressed interest in tools that could help in front-end screening and in distinguishing between investments that truly deliver double or triple bottom line results versus those that just pay lip service to the social bottom line. There was some interest in metrics that could assist in investment selection, but only in cases in which competing opportunities offered "identical" financial returns and the social commitment could serve as a differentiator.

Thus, interviewees argued for a rigorous screening process, as a careless one could do more harm than good. This lesson was recently learned by institutional investors in the subprime mortgage market who deferred to financial ratings provided by the big three rating agencies, which ultimately proved flawed. (Although it is possible that greater attention to the negative social impacts of the underlying activities might have given investors warning about the financial unsustainability of the investments.)

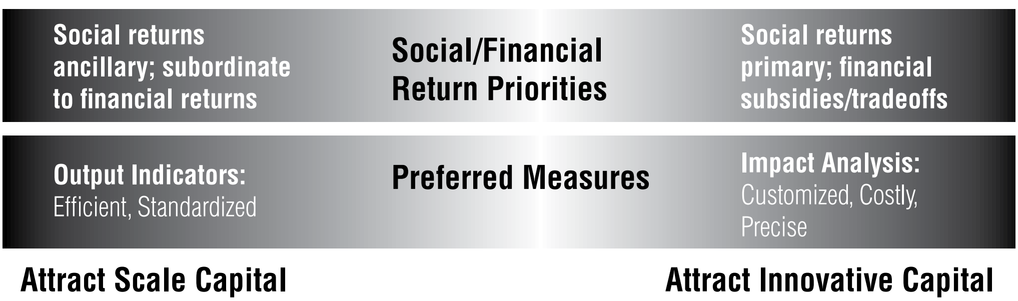
But perhaps the most fundamental opportunity identified is using social metrics to help define the space. As one interviewee put it, "Many want to answer, 'does it work?' [but first one must] also answer 'what is it?'" This comment suggests that the adage "you are what you measure" might also apply to this developing investment sector.

In raising these challenges and opportunities, we consider realistic next steps to advance the art of measuring the social returns and thus increasing capital to the underserved markets. We recognize that developments will be incremental. We hope to facilitate the exchange of information on the topic that includes information sharing by investors on social return evaluation resources and common questions to fund managers. An insight we gained from this process of information exchange is that measurements can take different forms for different purposes and audiences.

There currently exists a tension between calls for, on the one hand, development of such a ratings or high-level classification system, and on the other hand, undertaking deeper, more meaningful levels of social impact analysis. Champions of the latter would argue that data that are too high level do not properly capture the social return and broader impact of each investment, and do not allow investors to distinguish those investments with greatest impact.[23]

We recognize that the value placed on this process varies by investor. Rigorous and labor-intensive impact analyses conducted by mission driven funds have proved useful in strengthening theories of change and attracting subsidized and highly motivated financial and human capital. However, such depth of analysis does not necessarily attract scaled, market-rate funding from institutional investors such as banks and pension funds, who require easier-to-gather data. The following diagram illustrates (from left to right) how the social metrics have increasingly more specific input in the investment decision-making process.

Chart 3.



Source: J. Ratcliffe, "Who's Counting? Measuring Social Outcomes from Targeted Private Equity," Community Development Investment Review 3 (1)(2007): 23-37.

Thus, for a pension fund, for example, a ratings process could be helpful in the due diligence and investment decision-making process, similar to tools used for traditional investments, such as the Global Performance Investment Standards (GIPS). A ratings process for both the financial and social performance of targeted investments could provide a score (similar to CRA's scale from "outstanding" to "noncompliance") or signal the ability of a manager to perform on not only on the financial but also the social returns.

23 See, for example, the arguments made by Rutgers Professor Julia Sass Rubin: Rubin, J. (Forthcoming). All Developmental Venture Capital Is Not Created Equal: How the Rhetoric of Emerging Domestic Markets Can Hurt Distressed Communities. In Enterprise and Deprivation: Small Business, Social Exclusion and Sustainable Communities. Alan Southern (Ed.) New York, NY: Routledge Publications.

The following model provides a path for moving from scale reporting and classifications that facilitate capital flows toward custom measurements of true social impact. The six steps that an investor can take in identify, reporting on, and allocating capital to targeted investments by asset class include:

1. Define an investment theme or investment policy specific to an institutional investor's unique objectives (for example: targeted investing for public pension fund investors, environmental sustainability for environmental foundations, community development for foundations, banks or insurance companies),
2. Screen investments to "get in the room" for consideration. (Table 2 outlines some of the questions asked in the RFP process),
3. Report on social and environmental outcomes through third-party evaluators and tracking and documenting clearinghouses,
4. Benchmark targeted investments' social or environmental performance for a particular investment product with certification processes such as the LEED example in real estate, in the same way financial benchmarks are set, for example, by the Barclay's Capital Aggregate Bond Index for community development fixed income products.
5. Evaluate investment products through a ratings process or high-level classification system that allows for comparable measurement of impact across investment products (analogous to a Moody's credit risk rating)–for the purpose of allocating additional resources within each asset class.
6. Accurately quantify "impact" to drive innovation and impact policy - getting to the "theory of change".

We have argued here that to increase the flow of capital to private equity in underserved markets, investors need better social measures based on an investor's targeted social objective. In doing so, we explored the value investors place on the evaluation processes and how more rigorous systems could lead to greater investment. We observe that the more active an investor becomes in "double-bottom line" investing, the more they demand better social measures as a condition for investing. We also see that as social measures improve it enables investors to differentiate between two investments with similar financial track records, and that the social measures become the deciding factor for the investor.

Clearly, social and environmental metrics are increasingly important, and sharing resources, asking consistent questions, and engaging investors in the process will continue to advance the field. Although each type of institutional investor places a different value on metrics, the demand for social reporting is increasing. It may be a long time (if ever) before social impact metrics are so reliable that investors are willing to trade off financial returns (nor is this feasible for certain investors), but that is not the goal of this effort. Rather, the goal is to extract the value of the social return on investments in order to increase capital flows, thus promoting entrepreneurial activity and sustainable economic development in traditionally undercapitalized markets.

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