A Leanly Staffed Funder's Guide to Foundation Investing: 2020 Edition

EXPONENT PHILANTHROPY SPOTLIGHT REPORT

exponent philanthropy

IN THIS SPOTLIGHT REPORT

Introduction

Every foundation's goal is to have a thoughtful, disciplined investment process that is aligned with the foundation's purpose and goals. State law requires board members to act as prudent fiduciaries in caring for the foundation's assets. Over the long haul, good investment decisions can lead to more grants and the possibility of even greater impact.

As a foundation staff or board member, managing investments might be new or unfamiliar to you. This guide provides a high-level overview to quickly help you understand different aspects of foundation investment.

Within these pages, you'll find out how to start off with an investment policy statement (IPS), why your foundation needs an investment strategy, what choices to make about asset allocation, and how to ensure alignment with your foundation's objectives through mission investing. Each section highlights the most recent data from Exponent Philanthropy's Foundation Operations and Management Report, stories and case studies from our members on how they've approached various investment topics, and recommendations for further reading to learn more about each topic.

Investment Policy Statement

Developing an IPS sets a course for managing your foundation's assets through time. An IPS states in writing your foundation's mission and goals as well as how your investment policy and practices will help to achieve those goals. It includes specifics on where your assets are held, how they are monitored and evaluated, and who is responsible for each investment task.

In the Foundation Operations and Management Report, we report that nearly 80% of foundations have an IPS. Family foundations and independent foundations, foundations with between $10 million and $99.9 million, and foundations with no paid staff are all more likely to have an IPS.

Before writing your IPS, the board needs to discuss several key topics, including:

- Mission and program goals for your foundation
- Investment time horizon
- Spending policy
- Risk tolerance
- Diversification of assets
- Socially responsible investing and mission-related investing
- Duties and responsibilities for investing

Establishing a policy for your foundation's investments is not just about complying with the law, however. Your foundation's assets support your mission, and, in the best case, you should care for those assets as a way to further that mission. You'll find that investments are like most things in life: You can get by doing only the bare minimum, but your assets will never reach their full potential and may even suffer if that's all you do. Going beyond what the law expects will ultimately prove to be a powerful component in achieving your mission.

For more information on the benefits of an IPS and guidance on how to develop an IPS, see the Exponent Philanthropy primer "Creating a Strategy and Plan for Your Foundation's Investing: Developing and Using an Investment Policy Statement."

MANAGEMENT OF YOUR FOUNDATION'S INVESTMENTS

After developing your IPS, or as a part of developing your IPS, you need to identify who and how the work of managing your investments will be done. Foundations typically use one of five models for managing and overseeing investments:

- **Board does it all model**—The board does it all. It develops the foundation's investment policy, buys and sells assets, and monitors the foundation's portfolio(s).
- **Board and small staff do it all model**—The board and a small internal staff—which, in some cases, involve an internal chief investment officer—develop the foundation's investment policy, buy and sell assets, and monitor the foundation's portfolio(s).
- **Investment manager model**—The board (and internal staff) hires and directly oversees investment managers to buy and sell assets in accordance with the foundation's investment policy.

- **Investment consultant model**—The board hires an investment consultant to evaluate and hire managers to buy and sell assets in accordance with the foundation's investment policy. That consultant oversees the managers in your portfolio. If your foundation does not yet have an investment policy, the consultant can help the board develop one.

- **Outsourced chief investment officer model**—The board (with internal staff assistance) hires a firm that offers a full range of investment services on a nondiscretionary or a discretionary basis.

We report in the Foundation Operations and Management Report that a majority (83%) of foundations use an investment consultant or advisor for help with investment matters. And, on average, foundations have been using their investment consultant or advisor for about 12 years.

For more information on how to manage your foundation's investments, see the Exponent Philanthropy primer "Getting It Done: The Who and How of Small Foundation Investing".

Investment Returns

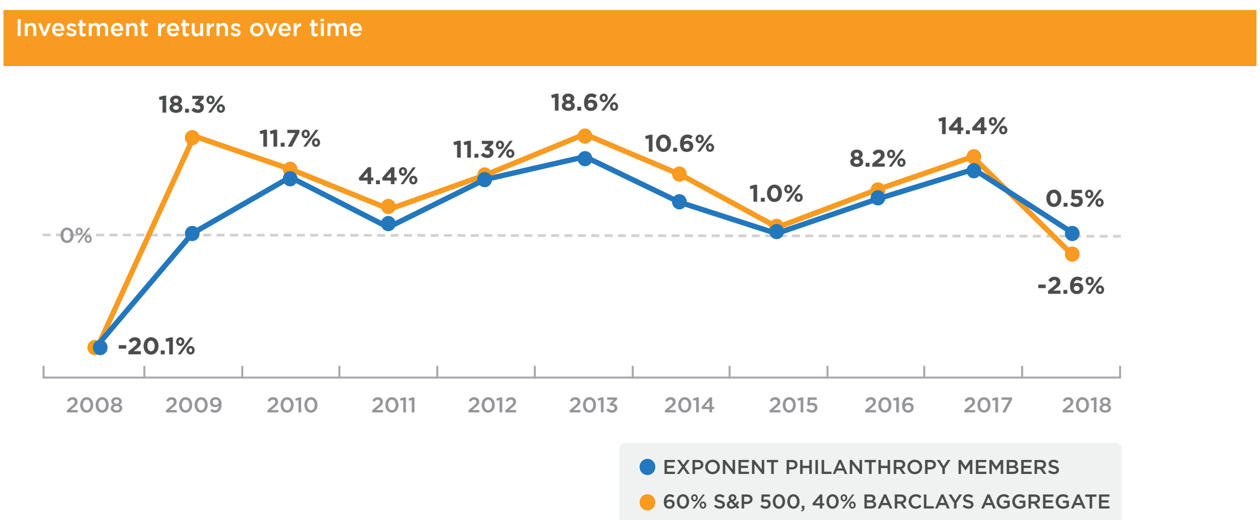
In calendar year 2018, the Foundation Operations and Management Report showed that foundations reported mean net investment returns of .53% and median returns of .57%. These findings varied somewhat by the organization's asset size:

OVERALL	<$1M	$1-4.9M	$5-9.9M	$10-24.9	$25-49.9M	$50-99.9M	100-199.9M	$200+M
.53%	.54%	2.8%	1.2%	1.8%	-.54%	-.32%	-2.3%	1.6%

It's important to note that in 2018, markets posted strong returns for most of the year but saw a significant downturn in the fourth quartes.

AVERAGE INVESTMENT TOTAL RETURNS AND BENCHMARKS

The following line graph shows how members' returns have compared to the overall markets over time. It reflects the total returns of Exponent Philanthropy members compared to a 60/40 blend of the S&P 500—a broad-based index of domestic large-cap companies—and the Barclays Aggregate—a broad-based index of investment-grade fixed income with allocations to the U.S. government, agency and mortgage bonds, and investment-grade corporate bonds.



You can see that member returns closely follow the market but tend to lag in bull markets, and they don't dip as low during bear markets. That 's a sign that foundation boards generally take a slightly more conservative approach to their portfolios compared to other investors.

For more details on returns over time, see Appendix E of the 2020 Foundation Operations and Management Report.

Case Study: Market Volatility in the Face of COVID-19

The director of administration and finance at the Cedar Tree Foundation in Massachusetts, Debra Moniz, who oversees the foundation's investment portfolio and manages two grant programs, shares her thoughts about the impact of the coronavirus pandemic on investments. She is not an investment professional, and the following opinions are her own and should not be constituted as investment advice.

COVID-19 is hitting investment portfolios hard with a series of precipitous plunges in asset values not seen since the market meltdown of 2008. The financial news is stomach-churning; all manner of "worst since," "biggest drop in" statistics accompanied by graphs with lines helpfully pointing straight down in case you didn't quite get the point. And the headlines keep piling on—air travel bans, college students sent home for the semester, major (and minor) events canceled.

Stock markets don't like uncertainty, and the situation continues to be frustratingly fluid. Until we see the peak of the virus and have a sense of how to calculate the economic impact, I expect volatility will continue.

For funders who rely on investment returns to fund their grantmaking, the situation is nothing short of alarming.

What Are Investment Experts Saying?

Several investment firms have put together calls and webcasts in response to market movements. I've sat in on many and will continue to do so. Hearing from professionals who have deep experience in the industry and have weathered many market events is extremely helpful.

I advise everyone to take advantage of what is essentially free advice from career investment professionals by joining these calls/webinars as you are able. Yes, some of the content can be confusing—I still have to do some brain gymnastics when talk turns to yield curves—but a good portion is fairly accessible.

Here's the gist of what I've heard on these calls: Do nothing. Stay the course. Don't worry. This happens. You are in it for the long term. If you sell now, you are locking in losses.

In short, the mainstream professional consensus is this spat of volatility should eventually pass and does not represent a fundamental unwinding of the financial system.

The case for holding steady is buoyed by the fact that, coming into 2020, the economic outlook was pretty good. The trade war had subsided. Consumers were financially healthy with relatively higher savings and lower debt. Unemployment rates continued to stay low.

How Is Cedar Tree Foundation Responding?

How hard is it to hear that inaction is the best action? Really hard, I think! Even though I know, logically, that trying to muck around with asset allocation and holdings while the market is in a free fall is a terrible idea, I still find it difficult to take comfort in the assurance of what should happen in the future when the present is so disquieting.

Here are some guideposts I've found helpful:

- **Maintain Information and transparency**—For better or worse, we live in an age in which news is available immediately and from multiple sources. I can keep myself and Cedar Tree's staff and board updated as often as daily on any developments in the market. We can continually reevaluate the situation. All of us are connected through email, phone, or text. If I need to reach anyone immediately, I can do so.

- **Use an investment consultant**—I found that having a consultant to turn to when things go south in the market is really helpful. Our consultant is showing her mettle by being super responsive and offering to host an impromptu call or to talk through any concerns the board might have. She assures me she and her firm are monitoring the situation and will be in touch immediately with any developments. I appreciate that the foundation has access to her expertise and experience.

- **Review your investment policy and asset allocation**—Any basic investment policy has asset allocation at its core, which is structured to incorporate both peaks and valleys in the market. Cedar Tree's allocation tends to have a slightly lower risk profile than the standard. It was really hard to see fixed income spitting out 2% to 3% returns when equities were returning double digits. But, right now, fixed income is the only asset class in the positive.

- **Stay the course**—This means sticking to your asset allocation and also standing by your grantees.

We Are Standing by Our Grantees

In my mind, the most important thought to keep foremost is this: The point of a foundation investment portfolio is to deploy funds in the world for charitable purposes. Supporting grantees in their work is Cedar Tree's guiding principle. We have no plans to curtail grant budgets despite the market drop.

Earlier, my foundation's staff sent a quick informal survey to a small set of grantees. What we learned is that while we are fretting over numbers on a graph and whether our telecommuting software is up to the challenge of an extended work-from-home scenario, we have a grassroots grantee whose employees won't be paid if they can't canvass door-to-door. And we have an urban farm grantee who is seeing orders canceled as events are put on hold and restaurants scale back.

Conceptual problems for us—how this will impact the portfolio's long-term value—are an immediate crisis for grantees—how to keep operating this month.

So, keep calm, take advantage of the professionals, and be there for your grantees. And wash your hands!

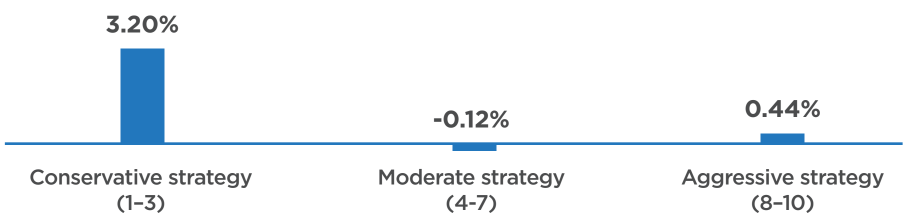
Investment Strategy

As you develop an IPS, one of the key decisions you will make is about your foundation's investment strategy. Some foundations choose an aggressive strategy to maximize their returns over time. Others opt for a more conservative strategy to prioritize preserving the foundation's endowment. And others choose something in between.

We asked foundations to rate their investment strategy on a scale from 1 (*very conservative*) to 10 (*very aggressive*). On average, respondents rated themselves as a 5.6, and the median rating was 6.0, with no significant differences in investment strategy rating by foundation type, geographic location, staff size, or asset size.

Foundations with a more conservative investment strategy had a significantly higher net annualized total investment return compared to foundations that indicated having a moderate or aggressive investment strategy. Market returns were generally down in 2018, so it is not surprising that a conservative strategy would have generated higher returns.

Net returns (as a percentage), by investment strategy (*n* = 258)

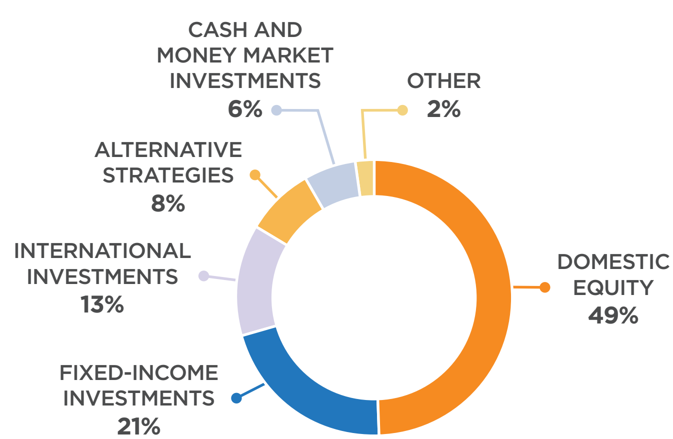


ASSET ALLOCATION

One of the main ways a foundation puts an investment strategy into practice is through its asset allocation. In earlier decades, foundations took a conservative approach with their portfolios. They invested 60% of their assets in stocks and 40% in bonds, and met their targeted returns of 7% (5% to meet their annual distribution requirement and an additional 2% to account for inflation) to exist in perpetuity. Our data shows that foundations are still targeting returns of about 7%; in calendar year 2018, targeted returns averaged 6.3%, and the median was 6.9%.

To meet their targeted returns today, foundation investments must balance domestic stocks, international stocks, a range of fixed-income options, alternative investments, cash and money market investments, and more. A typical foundation's 2018 asset allocation is shown in the chart. In general, foundations with an asset size of $50 million or over were more likely to use alternative strategies, whereas foundations with asset size less than $10 million were more likely to use cash and money market investments.

Investment portfolio allocations (*n* = 389)[1]



For more detailed information on asset allocation by the foundation's asset size, see Appendix E in [2020 Foundation Operations and Management Report](#).

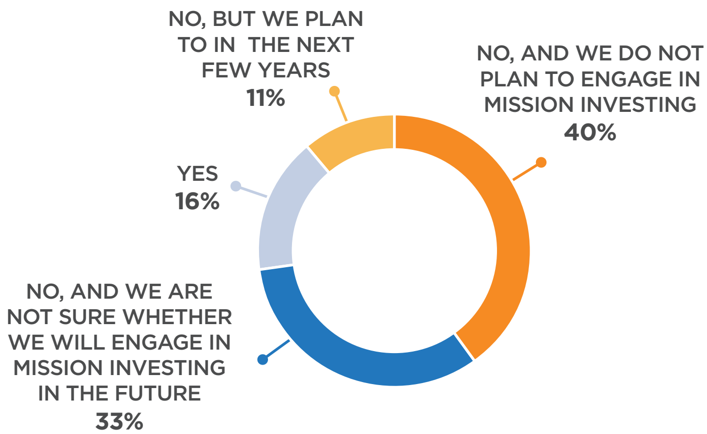
[1] Investment portfolio allocation categories are not mutually exclusive thus, percentages do not add up to 100.

Mission Investing

The Foundation Operations and Management Report indicates that 16% of foundations engage in mission or impact investing. We define mission investing as "investing in companies or projects that align with the foundation's mission and generate direct social returns in support of a foundation's mission in addition to market-rate financial returns."

Another 11% of foundations indicate they plan to engage in mission investing in the next few years. The remaining 73% of foundations do not engage in mission investing and have no defined plans to do so..

Engagement in mission investing (*n* = 459)



For more on impact investing, see Essentials of Impact Investing: A Guide for Small-Staffed Foundations, produced in partnership with Mission Investors Exchange and Arabella Advisors. In this actionable guide, you'll find definitions, key questions to consider, resources, and dozens of case examples from small foundations across asset classes and issue areas.

Case Study: Where Does Your Cash Sleep at Night?

Paige Chapel, president and CEO of Aeris, and Kristina L. Wahl, president of The Barra Foundation, offer guidance on local giving and investment in Community Development Financial Institutions (CDFIs). Since 2004, Aeris has established risk management standards for private community loan funds and has helped strengthen the development of impact measurement and management practices in the CDFI industry. Aeris also offers information to foundations and other investors that accelerates the flow of capital into impact investing. The Barra Foundation, a $90-million foundation with three full-time staff, invests in innovation to inspire change that strengthens communities in the Greater Philadelphia region.

Local giving is a priority for the vast majority of Exponent Philanthropy members. This is probably no surprise for those of us who associate charitable giving with supporting our local nonprofits, places of worship, or community members who are in need.

On average, like most private foundations, Exponent Philanthropy members give away approximately 5% of their assets each year. But what about the other 95% that are invested in return-generating financial instruments? Where does that cash "sleep" at night? In the local community where it can benefit people and places? Or on Wall Street?

These days, impact investing or mission-aligned investing are hot topics, but to many, it is not always clear how to get started. We suggest taking a look at mission-aligned investment opportunities in your own backyard: investing in CDFIs and supporting a local social enterprise.

Community Development Financial Institutions

CDFIs are private financial institutions with a 100% impact focus. They finance affordable housing, small businesses, and a range of community facilities—from schools, to health clinics, to arts venues.

The Barra Foundation discovered a great on-ramp to local investing in a loan fund managed by Philadelphia's Reinvestment Fund, an Aeris-rated CDFI. Individual and institutional investors like Barra loan money to Reinvestment Fund, which in turn uses those dollars to finance socially and environmentally responsible development projects that benefit low-income communities.

Investors—who can participate in the fund for as little as $1,000—earn a financial return while supporting mission-focused economic development projects. The paperwork is simple to complete, but investors do have to commit to leave their money in the fund for a minimum of 3 years.

What The Barra Foundation saw in Reinvestment Fund was a financial institution that had not defaulted on a commitment to an investor for more than 30 years. It also saw an opportunity to earn a market-rate return that was comparable to that offered by other types of fixed-income investments (e.g., bonds) with the added benefit of having local impact.

To make the investment, The Barra Foundation's investment committee and investment consultant first reviewed the prospectus (available online) and then approved the investment. Barra's investment consultant now tracks the loan fund in the monthly investment performance reports with all of Barra's other investments. Reinvestment Fund provides an annual report that describes its impact on communities.

In addition to loan funds, CDFIs also come in the form of banks as well as venture funds and credit unions. CDFI banks use depositors' funds in the service of helping underserved communities. Aeris, for example, keeps its operating cash in an account with City First Bank, a certified CDFI in Washington, DC, that serves residents, community-based organizations, and businesses in distressed, low-wealth communities. City First, like several CDFI banks, offers access to Certificate of Deposit Account Registry Service® (CDARS®) products, a program that enables City First to offer FDIC insurance for large deposits—that is, above the $250,000 insured limit.

To find a CDFI (bank, loan fund, venture fund, or credit union) that services your community, see Community Development Bankers Association (CDBA), National Community Investment Fund (NCIF), and Opportunity Finance Network (OFN), groups that maintain search tools to help you locate a CDFI bank in your community.

SOCIAL ENTERPRISES

What about investing directly in a social enterprise? In some cases, a pilot or test can be a great way to get started with mission investing while limiting your risk exposure. For example, a program-related investment (PRI) or recoverable grant can help orient investment decision makers to a new way of thinking about deploying financial resources. Some foundations have taken a first step by making a low-interest loan to a nonprofit or other entity they already know well.

Foundations face a decision with respect to the amount of risk they wish to assume with their mission-aligned investments. Investing directly in an enterprise can be riskier than investing through an intermediary (e.g., a CDFI), although, in some cases, a direct investment can make stakeholders feel more directly connected to the impact of the investment. A direct investment also can lower the cost of capital to the social enterprise.

The Barra Foundation provided a direct, low-interest loan to New Day Chester, Inc. (a for-profit social enterprise) to support the rehabilitation of several buildings at the core of an emerging arts district in Chester, PA. Unlike a grant that is not recoverable, a $250,000 loan with 4% simple interest in the form of a PRI will be paid back to Barra in 5 years; it can then be reinvested into another social impact project. Barra was able to share information—and risk—with two peer foundations that had experience making these types of direct investments. In this instance, Barra was willing to take a below-market rate of return because of the enterprise's potential to achieve a higher return on the foundation's impact objectives.

PUMP PRIMING

Mission-aligned investing frequently does not happen overnight. It requires staff and board education. Barra staff began to learn through resources like Mission Investors Exchange and from like-minded foundations. And, through educational sessions for its board, directors heard directly from experts in the field and recipients of impact investments. These sessions helped them understand more concretely, with examples, how an impact investment could benefit an end user, such as a social enterprise. Barra also had the chair of its investment committee chair and of the board meet with Reinvestment Fund directly so that the foundation's president did not need to act as a translator.

Barra's thinking about impact investing continues to evolve. The foundation plans to take more steps in the coming year to align a greater percentage of its assets toward mission.

Does your lean foundation have a success story or challenge related to mission investing? Exponent Philanthropy would love to hear about it.

MISSION INVESTING STRATEGIES

Board engagement is a critical step for implementing an impact investment strategy. Engage the board by learning what individual board members think about the possibility, educate the board on the state of the field, and take a broad survey of potential areas of interest or investment opportunities that spark the board's imagination.

Understanding what you currently have in your investment portfolio can guide your process. Foundations use impact investments to fund innovation, seed new enterprises, support the development of new markets, and expand access to critical products or services.

Here are common strategies:

- **Social screening and environmental, social, and governance (ESG) integration**—This strategy involves selecting or excluding companies in your portfolio based on social and environmental performance in addition to the company's financial performance. Many investors believe that integrating ESG factors into the investment analysis process can help deliver better risk/adjusted returns (this strategy is used most often in public equity investing).

- **Direct social investing**—Using this strategy, you invest in companies or projects (often in private equity) that generate direct social returns in support of your philanthropic mission—in addition to market-rate financial returns.

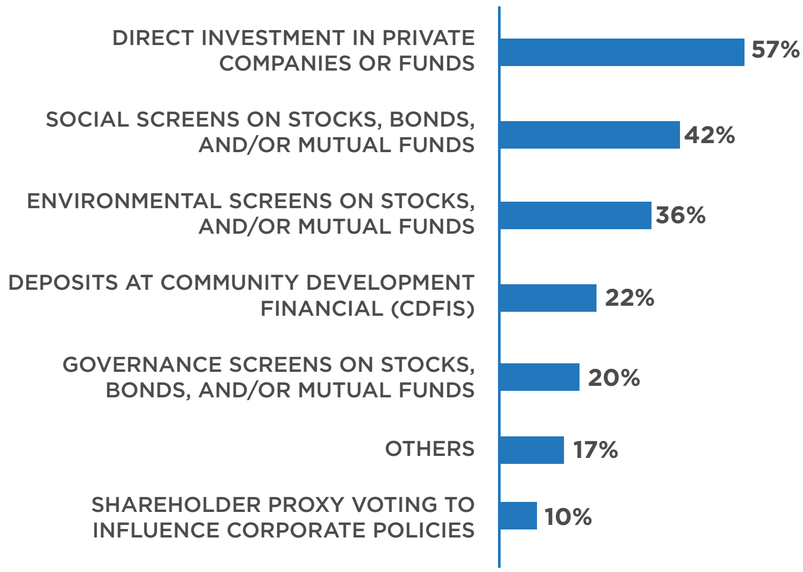
- **Shareholder advocacy**—This strategy involves using your power as an investor in a corporation to influence the corporation's policies, practices, performance, governance, and the degree to which it discloses its practices. Shareholder advocacy includes proxy voting and filing shareholder resolutions.

- **PRIs**—Using this strategy, you make below-market-rate loans and other investments with the primary purpose of accomplishing one or more of a foundation's charitable purposes.

Impact investing is practiced across all asset classes: cash and cash equivalents, fixed income, public equities, private equity, and real estate.

The *Foundation Operations and Management Report* details strategies foundations have used in mission investing. Many foundations make direct investments in private companies or funds (57%) or using social screens on stocks, bonds, and/or mutual funds (42%).

Mission investing approaches that foundations engage in (n=69)



Case Study: Use of Donor Advised Funds to Support Mission Investing

The California-based Skees Family Foundation, a small family foundation with about $2 million in assets, focuses on supporting the ultra-poor in developing countries through poverty alleviation, job creation, and education. The foundation typically makes grants between $2,500 and $15,000 to smaller, start-up nonprofits. Here, they share what led to their decision to open a donor advised fund (DAF).

The Skees Family Foundation recognized that with a relatively small grantmaking budget, its potential for impact was limited, so the foundation started looking into ways to further its mission through impact investing. The foundation learned about Village Enterprise, a nonprofit focused on creating a cost-effective and sustainable approach to poverty alleviation, and the nonprofit's development impact bond. The foundation wanted to find a way to invest a portion of its endowment to support the work of Village Enterprise. However, nonprofit's minimum investment amount was almost the same size as the Skees Family Foundation's corpus, so the foundation had to get creative.

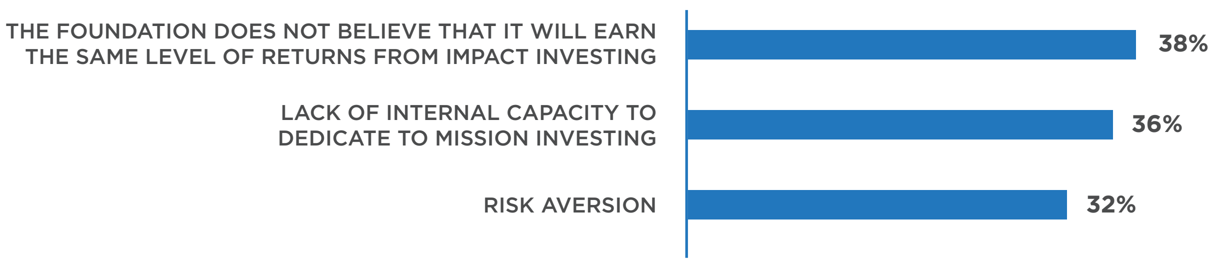
It opted to open a DAF with the organization Impact Assets. Doing so allowed the foundation to invest the DAF into a larger pool of funds investing in Village Enterprise's impact bond. This creative approach allowed the Skees Family Foundation to invest a larger amount of its corpus into a direct investment aligned with its mission without restricting the foundation's flexibility. Sally Skees-Helly, the foundation's CFO and director, said that the foundation's shift to giving multiyear grants was essential because it helped free up time so the foundation could focus on more creative approaches to impact investing.

BARRIERS TO MISSION INVESTING

Foundations report that their most common challenge associated with engaging in mission investing is the belief that this approach will not earn the same level of returns (38%). A similar percentage of foundations say they lack the internal capacity to dedicate to mission investing (36%).

Significant differences exist among respondents by foundation asset size: Foundations with an asset size between $10 million and $49.9 million are more concerned with the level of returns from impact investing compared to other asset size groups.

Challenges associated with mission investing (*n* = 324)



PROGRAM-RELATED INVESTMENTS

A powerful and flexible tool to add to your foundation's toolkit, a PRI is a loan, loan guarantee, or other type of investment a foundation makes to support a charitable purpose. But Exponent Philanthropy's data reveal that only 13% of funders make PRIs. For foundations working with few or no staff, PRIs can be an effective way to leverage limited assets because the funds tend to be recycled.

Although different from traditional grantmaking, PRI-making doesn't need to be intimidating. For guidance and a quick overview of PRIs, including key legal considerations, examples of projects funded through PRIs, and a list of questions to help you initiate a conversation with your board, see the Exponent Philanthropy Primer "Leveraging Your Assets With Loans and Other Program-Related Investments (PRIs)."

Case Study: Case Study: When $100,000 Goes Further Than a Traditional Grant

The Marion I. & Henry J. Knott Foundation, a Maryland-based foundation committed to strengthening the Roman Catholic community, describes how providing PRIs, also called cash flow loans, has impact on nonprofits.

Many nonprofits across the country struggle with financial viability, according to a report based on data provided by GuideStar. The majority have less than 1 month of operating reserves, and 30% face potential liquidity issues. Nonprofits in the education and health and human services sectors, which typically rely on government contracts and fee-for-service-revenue, operate with much tighter margins and are especially vulnerable to liquidity challenges.

Rather than shy away from these nonprofits, funders can play a special role in stabilizing their infrastructure.

The GuideStar report offers several suggestions, including additional support for overhead, more flexible funding, and policy changes for government funders. But it misses one critical way funders can help these organizations: PRIs. PRIs are essentially a loan or investment that counts toward a foundation's 5% distribution requirement. Rather than funds permanently leaving the foundation's corpus, they go out, do good, and come back to be used again.

CASH FLOW LOANS AT THE KNOTT FOUNDATION

The foundation in Baltimore has skillfully used PRIs to support its community. In the early 2000s, the Knott Foundation's executive director and board saw a need among their grantees for a source of low-interest, short-term cash to help make ends meet while they waited on delayed receivables. In 2003, after 2 years of research and work behind the scenes, the foundation introduced its cash flow loan program modeled on a similar program hosted by the Meyer Foundation in Washington, DC.

Through this program, the Knott Foundation provides loans at a lower cost and with a quicker turnaround time than typical lenders. It makes loans between $10,000 and $30,000 from a revolving pool of $100,000—since the inception of the program, the foundation has provided some 42 loans for more than $800,000. Even more impressive, the Knott Foundation has a 100% repayment rate.

For the few organizations that couldn't repay their loans within the 6-month repayment term (only 12%), the Knott Foundation worked with them to develop a mutually agreed on repayment plan to ensure that both organizations could remain in a financially healthy situation.

Knott Foundation Executive Director Kelly Medinger tells Exponent Philanthropy, "The loan program allows us to set aside a small percentage of our assets to provide a service that really benefits our grantees. It allows $100,000 to go much further than if we just used that money for traditional grants."

LOAN FUNDS AT WORK: TWO EXAMPLES

One of the Knott Foundation's grantees works to provide transitional and temporary housing to homeless individuals in Baltimore City. When Baltimore City's grant payment to the organization was delayed, the nonprofit applied for a cash flow loan to help meet its payroll needs. After receiving its grant from Baltimore City, the organization was able to fully repay the loan and went on to receive another grant from the Knott Foundation to help with a capital campaign.

Medinger emphasizes the foundation's commitment to help. "We make sure our grantees know that using our loan program doesn't put a black mark on their record. Grantees can apply for loans, and that will never hurt them in future grant applications."

Not all of the Knott Foundation's loans are used to cover late or delayed grant payments. Another Knott Foundation grantee working in community development used the cash flow loan program to help it purchase a house in an underdeveloped neighborhood. With funds from the cash flow loan program and a grant from another foundation, the organization was able to purchase the home, refurbish it, and sell it to a low-income city resident at a lower price than traditional developers.

PRIs and cash flow loan programs aren't just tools for large foundations. Funders of all sizes can use these tools to create a big impact in their communities and help nonprofits navigate difficult financial situations. All it takes is some creativity, due diligence, and the willingness to take on a little bit of risk.

To learn more about the Knott Foundation's loan program, check out its blog.

Investment Takeaways

To meet fiduciary responsibilities, it is important that board and committee members understand investment basics and what they mean to the organization. Here are key points for foundation staff and board members to remember:

- Develop an IPS to guide your foundation's investing as an essential first step. **Routinely review your IPS and update it as necessary.**

- Use various models to manage your foundation's investments. **Ensure that the foundation board and committee members establish and understand their roles and responsibilities.** which is critical to supporting the foundation's long-term financial health.

- Track your foundation's investment returns compared to market benchmarks, and take this important step each year. But remember: **Always consider the foundation's broader strategy and your goals**. Different asset allocations will lead to different investment returns.

- Consider how your foundation can align its investments to support or align closely with the foundation's mission. **Be aware that using other strategies like mission-related investments, socially responsible investing, and PRIs can help your foundation advance its mission more than your grant budget alone**.

Understanding the content in this guide is an important first step on your journey toward effective management of your foundation's investments.

As always, if you have questions regarding foundation investing, the Exponent Philanthropy community is here to help. We encourage you to reach out to your peers through our member directory and member discussion community to learn how other funders have navigated similar situations.

You can also submit questions to Exponent Philanthropy through our member Q&A service by calling 202-580-6560 or e-mailing **info@exponentphilanthropy.org**. Our staff will provide you with resources and in-depth knowledge based on our experience and expertise.

Appendices

Appendix A: Investment Terminology

Appendix B: Additional Resources

APPENDIX A: INVESTMENT TERMINOLOGY

Investing your foundation assets effectively can increase investment returns and thereby provide additional assets to help fulfill your charitable goals. Over the longer term, good investment decisions lead to the potential for more grants and greater impact. Poor investment decisions typically lead to fewer grants and lessen a foundation's impact. In addition, state law requires board members to act as prudent fiduciaries in caring for the foundation's assets.

Asset Allocation

Asset allocation is the distribution of assets within an investment portfolio across different types of traditional asset classes (e.g., stocks, bonds, cash, mutual funds, exchange traded funds) and across different types of alternative asset classes (e.g., hedge funds, private equity, real estate, commodities funds). Getting the decisions about allocation asset right is central to a foundation's investment strategy.

Extensive research has shown that asset allocation is likely your foundation's most important investment responsibility. Study after study has found that asset allocation decisions drive the achievement of investment performance objectives and can help moderate investment volatility in a foundation's portfolio.

Fees

Investment management fees are almost always quoted in basis points (bps), that is, hundredths of a percent times the amount of assets being managed. So, for example, 50 bps is .50%; the annual cost of managing $50,000 in a fund with a fee of 50 bps is $250 ($50,000 x .005 = $250).

Investors need to be sure they understand all fees associated with managing their assets, including asset management fees and any marketing, distribution, or sales fees or commissions; administrative fees; and fund expenses. Many different kinds of fees exist and vary typically by investment type, investment strategy, size of investment in a particular strategy/product, and so on.

Fiduciary Responsibility

A *fiduciary* is anyone who has the legal responsibility of caring for someone else's money. All foundation board members as well as investment committee members and investment advisors generally are called fiduciaries. Fiduciaries have the responsibility to carry out three duties: duty of loyalty, duty of care, and duty of obedience.

Fiduciaries do not have the legal responsibility for achieving a specified "target" annual return. The law, however, does require that fiduciaries be well informed about the assets under their care and that they follow a prudent process in caring for the assets entrusted to them.

Impact Investing

Impact investing, often called "mission investing" or "social investing," describes the intentional deployment of capital to meet two objectives simultaneously: to generate positive financial returns and to achieve specified social returns. Impact investing involves proactively investing in enterprises or activities that will result in a positive community or environmental benefit.

Impact investments are made by foundations of all types and sizes as well as by individuals. They include investments across all asset classes and along the entire spectrum of risk and return—from PRIs to market-rate investments that yield competitive rates of return..

Investment Policy Statement

An *investment policy statement* (IPS) states in writing your foundation's guidelines for investing that are tailored to help achieve the foundation's overall mission and goals. It also describes how your investment policy and practices will help to achieve those goals.

The basic purposes of an IPS are:

- To state in writing the board's attitudes, expectations, objectives, risk tolerance, liquidity needs, and other guidelines for investing
- To set forth an asset allocation and diversification plan for the foundation's assets
- To establish criteria to monitor, evaluate, and compare the performance results of any investment managers the board chooses to use
- To encourage effective communication between the board and any investment advisors

Rebalancing

Periodic rebalancing of your foundation's portfolio is an essential part of the ongoing asset allocation and investment processes. Investment professionals have suggested and debated a variety of rebalancing rules. The experts agree that you should rebalance on a regular basis.

On an overall basis, the central idea of portfolio rebalancing is to adjust allocations to various asset classes based on actual performance and projected performance so that you maintain a well-diversified portfolio, meet liquidity needs, and adjust for existing and projected changes in the external economic environment.

Spending Policy

A foundation's *spending policy* is the percentage of assets you plan to spend each year on grantmaking and other expenses related to fulfilling your mission. Your targeted/required return is the sum of your spending policy rate, the inflation rate expected over your time horizon, and net of all expected investment fees.

Working with Advisors

Once you have developed your IPS, the board or investment committee will have an important framework for implementing your foundation's investment strategy.

You must fill two distinct roles:

- **Managing the investments**—This role involves buying and selling assets according to the plan outlined in the IPS. It can be filled in different ways: by internal foundation staff alone or with advisory consultant assistance, or by a hired, paid investment professional who takes responsibility for all or part of a foundation's portfolio.
- **Overseeing the investments**—This role involves selecting, monitoring, and evaluating the investment managers, as needed, as well as the investments themselves. This role can be filled by an investment consultant (who also helps to develop an IPS) or a knowledgeable foundation manager subject to further oversight by the foundation's investment committee and/or overall board of trustees.

APPENDIX B: ADDITIONAL RESOURCES

Exponent Philanthropy's Investments Collection

This collection of four primers offers valuable information and guidance to the person who oversees your foundation's investments. These primers include:

- "Getting It Done: The Who and How of Small Foundation Investing"
- "Creating a Strategy and Plan for Your Foundation's Investing: Developing and Using an Investment Policy Statement (IPS)"
- "Essentials of Impact Investing: A Guide for Small Staffed Foundations"
- "Leveraging Your Assets With Loans and Other Program-Related Investments (PRIs)"

These resources offer your foundation's financial leaders a comprehensive overview of the challenges, and opportunities that come with investing your foundation's assets to advance your mission.

Benchmarking

Based on Exponent Philanthropy's annual Operations and Management Survey of foundation members, the Foundation Operations and Management Report published each year is a unique benchmarking tool that gives powerful insight into the grantmaking and operations of small-staffed foundations in the United States.

See Appendix E in the report for additional data on investment returns, asset allocations by asset size, and investment management fees and expenses:

Sample Documents

You don't need to start from scratch as you develop documents for your foundation. Exponent Philanthropy's sample document library has a number of resources to help you get started.

Four investment resources we encourage you to use are:

- Investment Policy Statement
- Investment Policy Statement With Impact Investment Components
- Investment Dashboard to track your expenses and investment returns
- A Guide to Hiring Investment Professionals