



FIELD GUIDE TO IMPACT INVESTING FOR AUSTRALIAN CHARITABLE TRUSTS AND FOUNDATIONS


Macquarie Group
Foundation



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Law

**IMPACT
INVESTMENT
GROUP.**



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They were supervised by Jessica Roth and Sally Garis.

The Social Impact Hub is also very grateful for the assistance of Hannah Zhang and Nick Harrington.

This guide was designed by Isabella Ali-Khan.

2015

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PREFACE

The Social Impact Hub brings university students together with industry, not-for-profits, social enterprises and foundations to develop and conduct applied projects in fields of social impact under the supervision of industry experts. This innovative program aims to foster the next generation of social change agents while providing not-for-profits and social enterprises with access to high quality, industry-standard consulting, policy, research, advocacy and advisory services.

In addition to our work directly with social enterprises and not-for-profits, the Social Impact Hub has also undertaken a number of thought leadership projects. This Field Guide is an example of such a project, where we identified that we could make a positive contribution to the impact investment sector.



The potential value of the impact investing market in Australia is estimated to be \$32 billion over the coming decade. The involvement of philanthropic organisations is necessary to help realise this growth, both through impact investing with their capital and funding capacity building initiatives through grants.

Although guides exist internationally, to-date Australian investors have been without substantial specific guidance in relation to impact investing. We hope this Guide will help increase the participation of trusts and foundations in impact investing and, in turn, contribute to the strength of the Australian impact investment market, as well as increasing the impact of charitable trusts and foundations.

We are grateful to the sponsors of this Guide – the University of New South Wales (UNSW) Faculty of Law, the Macquarie Group Foundation and Impact Investment Group. This is a wonderful example of collaboration across business and academia, giving students real world and meaningful experiences for academic credit. UNSW Law's commitment to experiential learning is remarkable and is widely commended by students and other stakeholders - it made a project like this possible.

We also express our thanks to the leaders in the sector who agreed to be interviewed and share their practical insights. Members of the Advisory Committee have each provided valuable contributions throughout the drafting of the Guide and we are very grateful for their assistance.

Congratulations to the Social Impact Hub students who worked on this project over multiple semesters - you should be very proud of your efforts!

A handwritten signature in black ink that reads "JRoth".

Jessica Roth
Founder & Director, Social Impact Hub

FOREWORD

I am delighted to write this foreword to the *Field Guide to Impact Investing for Charitable Trusts and Foundations* as it brings together a number of key interests of mine.

Over the years I have realised that a deep commitment to philanthropy can assist a person to be able to make a positive social impact in their own right. The latter being not only important to improving our world but also allowing an individual to feel good about themselves and the legacy that their life may leave in this world. I distinctly remember when a group of us were involved in advocating for the establishment of the initial Prescribed Private Funds (now called Private Ancillary Funds (PAFs)) way back in the early 2000's that we talked of two things.



First we knew that these foundations would become popular and would be an enormous impetus to giving in Australia. Second we knew that their success would necessitate more mature giving and this in turn would result in philanthropists and those administering these funds needing to be able to get assistance in how to give and indeed how to maximise the impact of their giving. We realised that in Australia the information and education that we believed would be required to maximise the impact of giving did not exist at that time. This Field Guide is the type of publication that we envisaged way back in the early 2000's would be needed.

Charitable trusts and foundations can play a special role in the impact investing sector. Foundations are set up for the purpose of doing good in the world, so arguably all of the assets of the foundation should be used to do so, not just those used for grants. Through deploying part or all of the corpus into impact investments, trusts and foundations can amplify the positive impact they have on society and engage with a broader set of solutions to social and environmental challenges, in addition to generating a financial return.

My family's charitable foundation recently made its first impact investment. It is early days but so far it's delivering a commercial financial return, as well as a positive environmental and social impact.

This Guide will hopefully help more trusts and foundations begin their impact investing journey and navigate the landscape professionally and properly.

It is personally very gratifying to me to note that this Field Guide was prepared with the assistance of students from the University of New South Wales. I believe very strongly that students working on real world problems and us benefitting from their thoughts and approaches is very desirable. The Social Impact Hub does just this and this Field Guide is a product of that emphasis.

I congratulate the Social Impact Hub on its initiative to develop this Guide and I thank all of those who were involved in developing it.

Impact investing is not going to solve all the problems faced in the world but it is an important tool that those of us with trusts and foundations could use as a complement to our philanthropy. Investing wisely is very important and publications such as this will assist enormously.

A handwritten signature in black ink, appearing to read 'David Gonski', written in a cursive style.

David Gonski AC
Chancellor, University of New South Wales

FOREWORD

As I read through the *Field Guide To Impact Investing For Australian Charitable Trusts and Foundations*, I am excited by the potential it has to shift more capital towards impact investments. My wife, Berry Liberman, and I started Small Giants with a very simple philosophy – to align our investments with our values. We were supporting issues such as action against climate change, poverty alleviation, gender equality, health, education, animal welfare and sustainability through our philanthropic donations and volunteering. We quickly realised that the money we were donating was coming from traditional investments which were not doing anything to help the causes we cared so much about. In fact, in some cases, our investments were actually contributing to the problems we were trying to solve. How could we expect to solve climate change if we put our money into fossil fuels? How could we expect to get gender equality if we invested in businesses that have few, if any, women on the board?



So we went on a journey of moving our money from traditional investments into businesses which deeply aligned with our values. It was important for us to take a total portfolio approach – meaning that our values would apply across all of our investments, not just to a single asset class. Our first steps were to upgrade the social and environmental credentials of our existing investments or replace the low performing ones with best-in-class assets. In the property market, measuring impact is quite well developed, with general standards such as greenstar, NABERS, LEED and other established rating systems, so that was an easy place to start.

Then we moved on to the next asset class, and found quality investments in renewables through solar and wind, and even discovered great opportunities in the private equity space, with start ups and existing enterprises. We also began to find some debt finance opportunities, with the Goodstart Early Learning social note paving the way for many more impact loans. Listed equities came last for us, but we are starting to see some exciting metrics and standards around companies that help us ensure they share our values, such as B Corporation certification, which now has a handful of listed entities in the movement.

With good advisors, a peer community of fellow impact investors and intermediaries to create and support opportunities, impact investing can be done successfully without necessarily increasing the risk profile of a portfolio. In fact, research suggests that the companies and assets that care for the community and the environment tend to do better in the long term. And this is exactly what this guide is all about. It is a tool for Australia's trusts and foundations (and eventually, all of Australia's wealth) to do more, to make a bigger difference, to use all the tools in our toolbox, not just granting, to solve the problems that are holding us all back from our true potential.

Trusts and foundations are not simply investment companies that donate their profits to charity. Our purpose is clear, and we must find a way to align our investing with our mission and values. The following pages will show you how. Philanthropy is the love of human kind, encapsulated in all the great traditions through the concept of love thy neighbour. It is not an act of charity, it is a philosophy of being. Our challenge is to live that philosophy in everything we do, including our investing.

See you on the journey,

A handwritten signature in black ink that reads "D Almagor". The letter "D" is large and stylized, followed by the name "Almagor" in a cursive script.

Danny Almagor
Chairman, Impact Investment Group

EXECUTIVE SUMMARY

In line with global trends, Australia is witnessing growing interest and activity in the impact investment market as the private sector and government seeks innovative solutions that create a more inclusive and sustainable society.

Investments with the specific objective of generating positive social and environmental impact as well as financial return have already been implemented by charitable trusts and foundations, in addition to institutional investors, high net worth individuals and family offices. Impact investment by charitable trusts and foundations offers a compelling opportunity for these organisations where consistent with their fiduciary duties to increase their impact by utilising their corpus in addition to traditional grants to address social and environmental problems. Additionally trusts and foundations can play a key role in catalysing and attracting additional capital into the emerging impact investment market.

Despite the significant potential for impact investment, only a small number of Australian charitable trusts and foundations have implemented an impact investment strategy. Understandably, trustees are very concerned about ensuring they meet their fiduciary duties and in the absence of any guidance many are reluctant to enter unknown territory. There have also been significant challenges in understanding new concepts and overcoming perceived barriers to enable trusts and foundations to move from cautious enthusiasm to active participation in the impact investment market.

This Impact Investing Field Guide for Charitable Trusts and Foundations builds upon the report *Impact Investments: Perspectives for Australian Charitable Trusts and Foundations* by Kylie Charlton, Scott Donald, Jarrod Ormiston and Richard Seymour. This guide seeks to provide a comprehensive roadmap for Australian charitable trusts and foundations to design and implement an impact investment strategy. The step-by-step guide delivers theoretical and practical insights to the reader by showcasing best-practice theory with a spectrum of real case studies from domestic and international philanthropic organisations to highlight the variety of ways foundations can participate.

The introductory sections of the guide define impact investment and present the case for charitable trusts and foundations to participate in this growing Australian market.

The following sections cover getting started, the design of an impact investment strategy and include gaining consensus amongst company directors or trustees, drafting impact investment policies and strategies. Recommendations are made with an appreciation of the different legal structures and modus operandi and resources of Private Ancillary Funds, Public Ancillary Funds and traditional Foundations. Trustees of charitable trusts and foundations, as they do with all their activities, need to assure themselves that impact investing is within the purpose of their trust and, where they exist, the Guidelines governing their activities.

The final sections of the guide focus on implementing and managing the impact investment strategy: from sourcing and evaluating investment opportunities; to considering portfolio diversification; to assessing impact outcomes and monitoring investment performance.

“ I would love something that articulates in one detailed document what the legal or regulatory implications are for different forms of impact investing. A field guide that says “this is what you need to do” would be so helpful rather than having to dig around to piece it together myself.

Cathy Truong – Trawalla Foundation ”

ADVISORY COMMITTEE

We are very grateful to the advisory committee of industry experts who assisted on this project. Their biographies are below.



Kylie Charlton is the Chief Investment Officer of Australian Impact Investments, and the Managing Director and Co-Founder of Unitus Capital. Kylie has been an active contributor to the rise of impact investing in Australia. Her experience ranges from arranging capital for microfinance institutions to advising government and not-for-profits on impact investing. Kylie graduated from the University of Canberra with a Bachelor of Commerce degree, majoring in Banking & Finance, and completed an MBA at Saïd Business School at the University of Oxford.



Paul Steele is currently CEO of Donkey Wheel Foundation, a charitable trust that aims to generate both financial and social returns. Furthermore, Paul is currently the Executive Chairman and Co-Founder of The Difference Incubator -an incubator of investable social enterprises, the Executive Director of Ethical Property Australia -a company that raises social impact investment to purchase and refurbish properties, and the Co-Founder and Director of Benefit Capital -a company that offers impact investment services. He has also consulted and mentored widely in both strategy and innovation.



David Rickards is currently the Founding Executive with Social Enterprise Finance Australia Ltd (SEFA). SEFA provides debt finance to organisations that have a positive social, cultural or environmental impact. Additionally, he is a Chairman at NAOS Emerging Opportunities Company and Director and Trustee of the Australian Museum Foundation. Previously, he was the Global Head of Research at Macquarie Group. He completed his undergraduate degree at University of Sydney, and completed an MBA at University of Queensland.



Lisa George is the Global Head of the Macquarie Group Foundation. She currently sits on the YWCA NSW board, and is also the Co-President of the Harvard Club of Australia. She has a deep involvement in philanthropy through her current role at Macquarie Foundation and has also been involved in impact investing through her role at Social Ventures Australia and her position on the Advisory Council of the Centre of Social Impact. Lisa completed a masters degree in public policy at the John F. Kennedy School of Government at Harvard University, and completed her undergraduate education at the University of Pittsburgh.



Caroline Vu is in the strategy teams of impact investing firm, Small Giants, and impact investment funds manager, Impact Investment Group. Previously a commercial lawyer with Pigott Stinson Lawyers, she managed Philanthropy Australia's impact investing program and founded Australia's first program to connect and develop emerging leaders in giving, the New Generation of Giving Program. She is an alumni of the 2012 Sydney Leadership program. Caroline graduated from the University of Technology, Sydney with an LLB (Hons).



Will Richardson is the Chief Investment Officer at Impact Investment Group (IIG). Will oversees IIG's investment portfolio and investor relations. He has over 15 years experience in the private equity, property and corporate finance sectors. Will has provided investment advice to organisations, families and high net wealth individuals. He was previously the Investment Manager and Executive Officer at the CVC Group, after beginning his career at Ernst & Young. Will is a Director of the Responsible Investment Association of Australia and a Director of Right Now, a not-for-profit human rights media organisation.

We are also very grateful to Scott Donald and David Ward for reviewing the Guide from a legal and tax perspective:



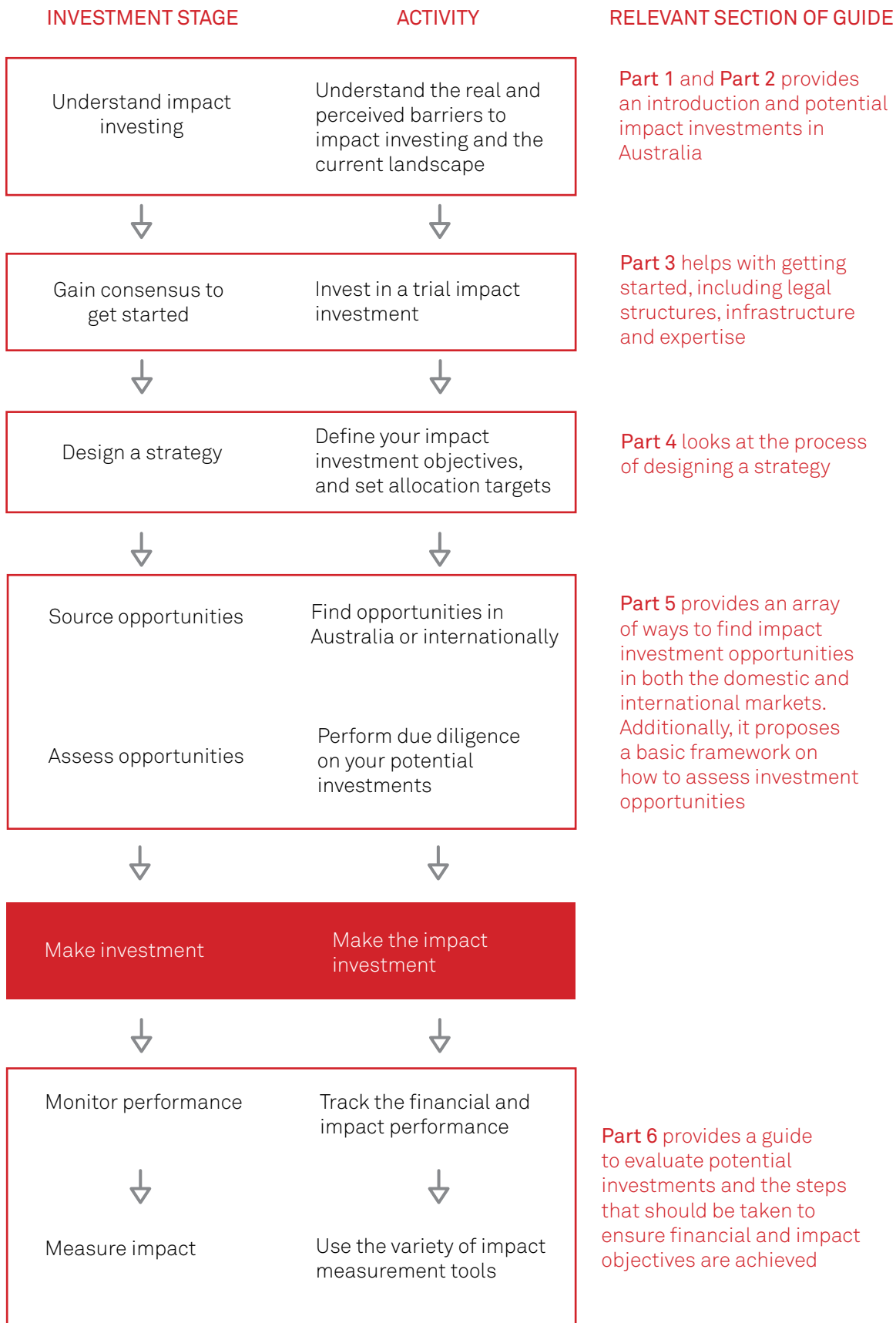
David Ward is Technical Director and Board member of Australian Philanthropic Services. He served for 10 years on the Council of Philanthropy Australia as Treasurer until 2015. He is the author of three Trustee Handbooks for Philanthropy Australia, lectures at the Asia Pacific Centre for Social Investment & Philanthropy, Swinburne University, on governance and structure of charitable trusts and was a member of the international panel that developed the Investment Management Code of Conduct for Foundations for the CFA Institute in 2010.

David had 20 years experience as a senior financial market executive with ANZ including Chief Economist ANZ (NZ), and in Melbourne General Manager Group Investor Relations and four years as CEO of ANZ Trustees.



Scott Donald is Director, Centre for Law, Markets and Regulation, UNSW Law. He is also an external consultant to Herbert Smith Freehills. Prior to joining UNSW Law, Scott advised a wide range of public and private sector organisations in Australia and overseas on issues associated with the regulation, governance and investment of superannuation and investment funds for Russell Investment Group and before that Ipac. He was a consultant to the Super System Review in 2010 and was a joint winner of the inaugural Research Prize at the 7th Annual Australian Sustainability Awards in 2008.

HOW TO NAVIGATE THIS GUIDE





PART 1 | UNDERSTANDING IMPACT INVESTING



This section provides an introduction to impact investment in Australia: what is it, what is its potential, and outlines the global and Australian landscape.





IMPACT INVESTING: DEFINITIONS AND TERMINOLOGY

“Impact investments are investments made into companies, organisations and funds with the intention to generate measurable social and environmental impact alongside financial return” (Global Impact Investment Network)¹

There are many emerging definitions and interpretations of the term impact investment. This guide uses the Global Impact Investing Network (GIIN) definition due to its broad acceptance domestically and globally by the peak financial industry and professional member groups, including the Responsible Investment Association Australia and the Global Sustainable Investment Alliance.² At the heart of the definition, impact investing can be seen as a way to provide capital to ventures that generate a social or environmental benefit. The three key characteristics of an impact investment that underscore the definition are:³

1. **Intention** – the investment opportunity must be designed with a specific objective to achieve social and/or environmental impact. Investments where the impact is unintended are not considered impact investments.
2. **Measurable impact** – the impact is able to be measured and then reported.
3. **Financial return** – the return on investment can range from concessionary (below market) through to market-rate and market-beating returns, but there is an expectation of at least return of capital.

The expectation of financial return differentiates impact investing from philanthropy and the specific objective of making and measuring impact differentiates it from traditional forms of investment. There are also differences between impact investments and other forms of ethical or socially responsible investments and it is helpful to understand these differences. The table below highlights the spectrum of common investment typologies:

FINANCIAL CAPITAL		IMPACT INVESTING		PHILANTHROPY
TRADITIONAL	RESPONSIBLE & SUSTAINABLE	FINANCIAL-FIRST	IMPACT-FIRST	
Competitive Financial Return		Competitive Social Return		
FINANCE ONLY 		 + 		IMPACT ONLY 
Limited or no consideration of social or environmental impact	Avoid investments that create a negative impact	Intentionally set out to deliver positive social or environmental impact and financial return		No return on principal expected

Impact investments can provide capital to a range of businesses and funds that generate sustainable and scalable solutions to problems that cannot be realised by negative screen investments or philanthropy alone.

Impact investing is distinctly different from socially responsible investing. Socially responsible investments generally apply a set of negative or positive screens to an investment. Negative screening involves avoiding or excluding investments with low environmental, social or governance metrics, and screening companies under certain criteria. In contrast, impact investing goes beyond passive screening by seeking investment opportunities with the goal of effecting either or both social and environmental change with returns that may be below, at, or above market.

As can be seen from the table above, across the spectrum of impact investments, there are varying levels of financial return. This reflects the differing risk appetite and requirement for financial return from various investors.⁴

Some people believe that there is a ‘trade-off’ between financial return and social impact, and one needs to be prioritised over the other. The following terms are sometimes used:

- **Finance-first impact investments** aim to maximise financial return with a ‘floor’ of social or environmental impact in a given asset class. This means that investors set minimum impact objectives that must be considered when selecting investments, however the expectation is that these investments will generally achieve financial returns that are competitive with traditional investments.
- **Impact-first impact investments** aim to maximise social and/or environmental impact with a floor of financial return. Impact first investors are primarily driven by their desire to create impact and are therefore willing to accept a below market financial return and/or take higher risks to achieve these objectives. Philanthropic trusts and foundations are more likely to use this type of investment as an adjunct to their granting strategy, rather than institutional investors.

Others believe in true blended value:

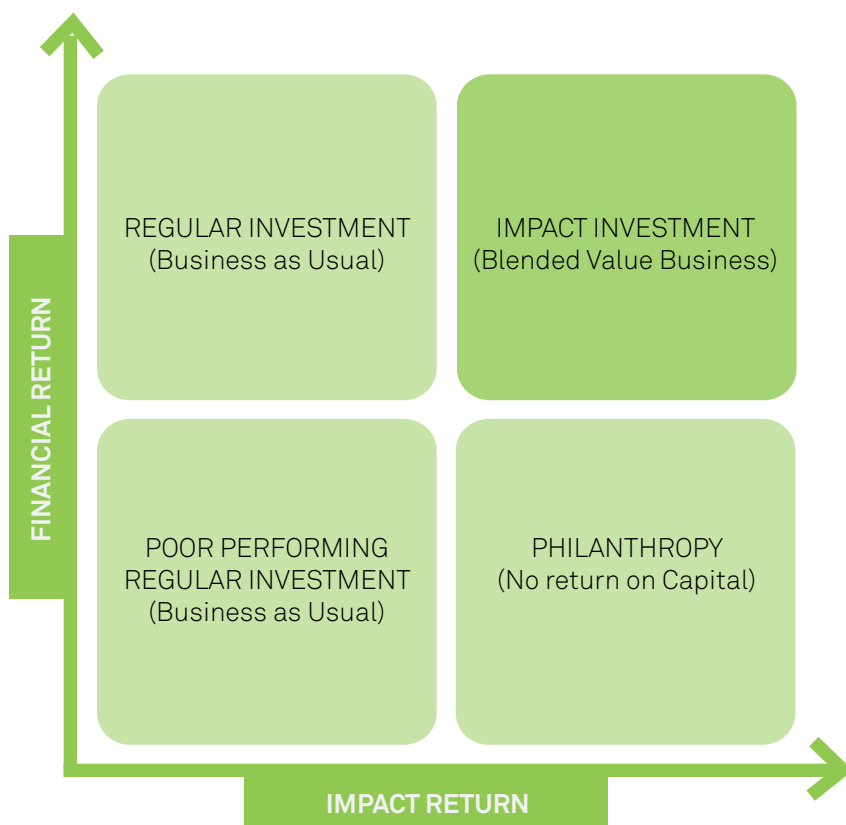
- **Blended value investments** aim to create sustainable, long-term solutions to global challenges through strategies that neither prioritise economic return nor social return, but rather a blend of both. They are located in a space between philanthropy, where no financial return is expected, and pure financial investments, which does not focus on social or environmental outcomes.



From a Donkey Wheel perspective, we genuinely believe that blended value is possible, generating both market rate type of returns and a significant social return. The underlying reason behind this is that if we can't realise blended value, then we cannot unlock the full potential of the capital markets and its ability to do good in the world.

– Paul Steele, Donkey Wheel Foundation





There are also other terms frequently used in the US that specifically relate to charitable trusts and foundations:

1. **Program-related investment (PRI)** describes an investment into a specific program that serves to achieve a specific charitable purpose. Legislation in the US clearly allows these investments to count towards a foundation's mandatory distribution requirements of 5% of the value of net assets.⁵ The situation in Australia will be discussed further below.
2. **Mission-related investment (MRI)** describes an investment that is specifically aligned with and designed to support the mission of the foundation and target market-rate returns. The key distinction is that MRIs cannot be counted towards the foundation's minimum distribution requirements and are therefore made out of the corpus of the foundation.⁶

TYPES OF IMPACT INVESTING

Impact investing embraces a wide variety of sectors, asset classes, regions and approaches. There is still some debate about the definition and boundaries of impact investment. One view states that impact investing represents its own asset class. This was set out in a 2010 JP Morgan report titled *Impact Investments: An Emerging Asset Class*. However, this view no longer seems to be widely accepted. Rather, this Guide adopts the alternate view that impact investing can be seen as a 'lens' or an investment philosophy that can be applied across the range of existing asset classes.

INVESTING ACROSS ASSET CLASSES AND SECTORS

ASSET CLASS	EQUITY 	DEBT 	PROPERTY 
EXAMPLE	 <p>\$0.3m investment by STREAT in equity with a forecast IRR of 7-12%p.a.</p>	  <p>In 2015, Social Ventures Australia and Social Enterprise Finance Australia (two of the SEDIF funds – see p 24) both loaned \$785,000 to Sustain Community Housing to provide finance for the construction of affordable and social housing in Colyton in western Sydney.</p>	 <p>Impact Investment Group (IG) invested \$33.5m in December 2013 in the EPA building in Melbourne with a target IRR of 18% p.a. IIG exited in 2014 at a price of \$42.3m, representing a 26.1% premium to the purchase price.</p>
IMPACT CREATED	<p>Provides disadvantaged and homeless youth with the life-skills support, work experience and training needed to enter the hospitality industry.</p>	<p>Sustain Community Housing aims to provide affordable housing, social housing or independent housing to low income households and those with other needs.</p> <p>The new development of six 4-bedroom dwellings complex will provide an innovative next housing model. Four of the six dwellings have been sold off the plan with two retained to be used as affordable housing, managed by a Community Housing Provider.</p>	<p>The building is one of the most environmentally sustainable commercial buildings in Australia with a Six Star Green Star rating; one of only sixteen buildings in Australia with that rating.</p> <p>The building’s anchor tenant, the Environmental Protection Authority, occupies four levels of the building. In May 2014, the vacant top two levels of the building were leased to Trinity College of the University of Melbourne, which it uses to provide access to education for international students.</p>
SECTORS	 <p>SUSTAINABLE EMPLOYMENT</p>	 <p>HOUSING</p>	 <p>CLIMATE CHANGE</p>



INFRASTRUCTURE



FIXED INCOME



CASH



OTHER



IIG, together with its co-investors, invested \$16.3m in the Chepstowe Wind Farm. IIG's equity was structured as 50% pure equity and 50% shareholder loan with an 8% coupon. Blended IRR forecast of 10.5% p.a.

The windfarm has now been commissioned and will generate enough power for 4000 homes.

24,000 tonnes of CO2 are expected to be offset.



Goodstart Early Learning took on a layered investment. The complex structure included unsecured social capital notes of \$22.5m to 41 private investors, paying 12% p.a. over 8 years (although it was paid out ahead of schedule).

Quality childcare for 73,000 children in over 650 childcare centres; employment for 15,000 people.⁷ It prevented a vast number of child-care centres from going into insolvency.



Bank Australia (formerly bankmecu) is a customer owned responsible bank. It currently has 127,000 personal customers and 800 community organisation and school customers, with more than \$3 billion in assets.

The impact is limited but profits are reinvested back into the bank to provide all customers with fairer fees and better interest rates.

Invest up to 4% of the bank's after tax profit in a Community Investment Program, addressing a range of community and environmental issues. Conservation Landbank helps reduce negative impact on the environment.



\$7m investment by Newpin in a social benefit bond with an IRR of 10-12%

This is being used to fund the expansion of a successful program that works with families to either safely return children in care to their families or prevent them from entering care in the first place. The Newpin SBB targets a financial return of 10% to 12% per annum for investors over the seven-year term of the bond. More detail about social benefit bonds is provided on the next page.



CLEAN ENERGY



EDUCATION



COMMUNITY WELLBEING



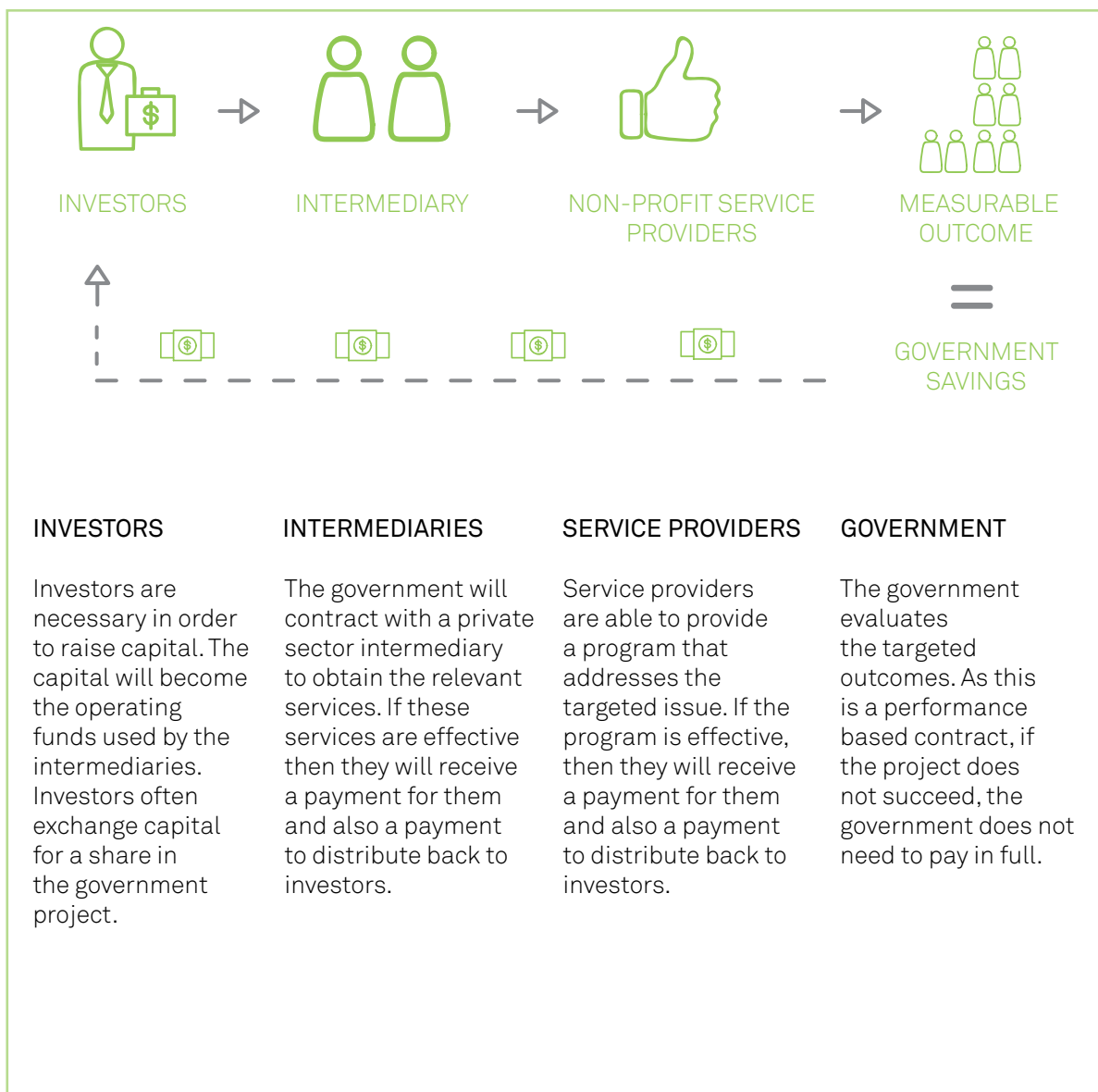
REDUCING OUT-OF-HOME CARE

SOCIAL BENEFIT BONDS

A social benefit bond is a relatively new financial instrument in which private investors provide up-front funding to service providers to deliver improved social outcomes. If these outcomes are delivered, there are cost savings to the government that can be used to pay back the up-front funding as well as provide a return on that investment.⁸

Social benefit bonds provide a mechanism to share risk amongst investors, service providers and government.

The diagram below depicts the flow of funds in a typical social benefit bond. For further detail about the first Australian social benefit bond, please see Appendix 4.



THE CURRENT LANDSCAPE AND MARKET POTENTIAL

GLOBAL LANDSCAPE

The global impact investing market has accelerated rapidly over the past decade, supported by policy developments, the emergence of pioneering market builders and a growing investment appetite. The majority of supply of impact investment capital originates from North America, the United Kingdom, Europe and Asia-Pacific. However, the demand for impact investment extends from developed countries to the developing world and includes investments made into for-profit, hybrid and non-profit ventures spanning a broad range of social and environmental impact objectives.⁹

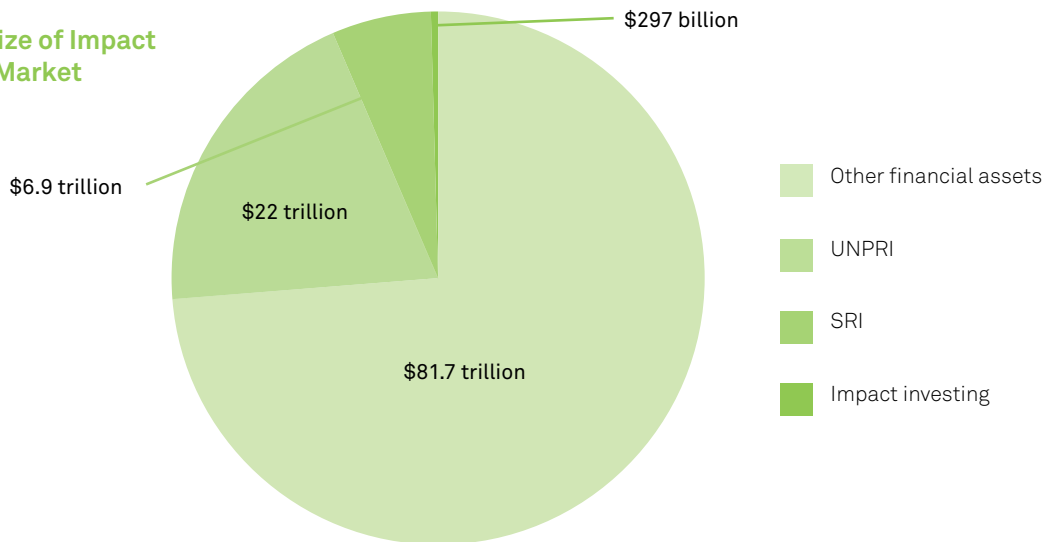
Current size and potential of the market

Due to the broad range of definitions and approaches to impact investment, it is difficult to accurately determine the current size and potential of the global market and estimates vary significantly.

- Monitor Institute estimated the size of the market at \$50 billion with a projected growth to \$500 billion by 2019. This represents 1% of total assets, estimated at \$50 trillion.¹⁰
- JP Morgan calculated that the total amount of impact capital managed by 2020 could be between \$US400 billion and US\$1 trillion.¹¹

The graph below provides an indication of the size of the impact investment market, relative to other financial assets:

Relative Size of Impact Investing Market



Source: JB Jaquier, *Guide to Impact Investing for Family Offices and High Net Worth Individuals*, p24.

Expectations of return and impact

In most cases, it is too early to determine the realised returns of many impact investments. However, a 2015 analysis of 51 investment funds with social and financial objectives found that impact investment funds can have even stronger financial returns than conventional funds. The impact investment funds in the study showed a 6.9% average internal rate of return, compared to 8.1% from comparative non-impact investing funds.¹² The Global Impact Investing Network's CEO Amit Bouri has commented:

“We are encouraged that impact investing funds have performed so closely with peer funds in the comparative universe... this demonstrates that market rate returns are achievable through impact investing.”¹³



In addition, a report released by the Aspen Institute indicates that 80% of surveyed investors are meeting or exceeding financial targets and 90% are meeting or exceeding social metrics.¹⁴ This early stage data serves to demonstrate the success and significant potential impact investing represents, although it is acknowledged that additional time is needed to demonstrate a consistently strong track record.

A report from the World Economic Forum (WEF) estimates that approximately 35% of impact investment funds are targeting IRRs above 20%. These IRR targets vary based on geography, sector, financial instrument, and investor type. Moreover, another 35% are targeting IRRs between 11-20%.¹⁵ These targets are indicative of the relative confidence fund managers are placing in the results that can be achieved with impact investing.

AUSTRALIAN LANDSCAPE

Australia’s impact investing market is still relatively young and immature. Following global trends, Australia has seen the emergence of a diverse range of deals of various sizes and across various asset classes. Whilst the overall scale of activity is small in comparison to the international impact investment market, Australia has been at the forefront of some innovative impact investments, including the NSW Social Benefit Bonds (see Appendix 4 for further detail on the first Australian social benefit bond) and three government backed funds.

THE SEDIF FUNDS

The Social Enterprise Development and Impact Funds (SEDIF) aim to improve access to finance and support for social enterprises to facilitate the growth of their businesses, and also increase their impact. The Australian government contributed \$20m to seed the three funds, which was matched by private investment.

FUND MANAGER	DESCRIPTION
	<p>Foresters Group (Foresters) provides community finance loans and services to improve their financial capacity and resilience of people, social enterprises, non-profit organisations and communities who are financially excluded. Foresters also offers a range of social investment products to investors who are looking for a financial and social return. Their aim to create positive social, cultural and environmental impact whilst generating financial return for their investors.</p>
	<p>Social Enterprise Finance Australia (SEFA) provides tailored finance solutions to mission led organisations. SEFA is leading the development of social impact lending in Australia, using innovative solutions to build a stronger and more dynamic social sector. SEFA is committed to fostering positive community, indigenous and environmental impact whilst achieving financial returns.</p>
	<p>The Social Ventures Australia (SVA) Social Impact Fund aims to provide capital, both equity and debt to social enterprises. Furthermore, it aims to improve both economic and social inclusion for Australian communities that experience disadvantage.</p>



In addition to these three fund managers, there is also the Impact Investment Group that has transacted on over \$300m of real assets and infrastructure. Investment funds make up a segment of a larger market, which includes many small organisations, including a number of charitable trusts, corporate foundations and family offices that have committed their corpus to impact investing.

Current size and potential of the market

The IMPACT Australia report estimated that in 2012 there was AU\$2 billion in assets under management and impact investments reached \$300 million, with a projected growth to \$32 billion over the next 10 years.¹⁶

Expectations of return and impact

Similar to global trends, return expectations for Australian impact investments vary across asset classes, sectors and impact objectives. Due to the limited number of deals and lack of track record for deals across asset classes, it is difficult to benchmark the success of the deals. The table above on page 20-21 shows a select number of Australian impact investments that have achieved or are projected to achieve competitive financial returns.



There are not enough impact investments in Australia at the moment, so the (Donkey Wheel) Board has not had to choose between them

– Paul Steele, Donkey Wheel Foundation





PART 2 | MAKING THE CASE FOR IMPACT INVESTING



WHY IS IMPACT INVESTING IMPORTANT?

Impact investing has emerged against a backdrop of longer-term global economic, environmental and population trends (see table below). It is becoming increasingly apparent that government funding and philanthropic grants are insufficient to address current societal problems. They are also inadequate to fund the array of innovative solutions that are emerging to address pressing social and environmental challenges.

The supply and demand factors of impact investing include:



SUPPLY



DEMAND

Global Impact Investing Network has gathered over 60 investors, which represents around \$60 billion in impact investments

Economic and population growth driving a focus on resource use efficiency

The G8 has created the Global Social Impact Investment Taskforce

Decline of extinction of natural habitats, plant and animal societies

Governments have begun address the legal and regulatory barriers to impact investing

An ageing population placing greater demand on services and the labour market

Over 30 US states have enacted legislation that recognises “Benefit Corporations”, legitimising the pursuit of social objectives at the expense of profit maximisation

Demand for more efficient human service delivery from government agencies and the private sector

Grants have played an important role by providing catalytic funding

Unprecedented technology development

Capital providers such as foundation, high net worth individuals and financial institutions are interested in diversifying their investment portfolio

Emerging expectations of the role of the corporation through CSR and ESG practices

Put simply, impact investing represents a powerful opportunity to direct the flow of capital towards solutions that achieve a positive impact. Around the world, impact investment is succeeding in catalysing new markets and encouraging social innovation. Impact investing is providing investors new opportunities to deploy their capital in ways that not only align with their values and create benefit to society, but also provide a financial return.

More broadly, impact investment represents a potential solution to the inability of government and philanthropy to address the wide array of social and environmental challenges facing our modern world. The private sector, social sector, governments, communities and philanthropic trusts and foundations can all benefit from the opportunities impact investing can offer:¹⁷

- Investors – now have the opportunity to align their investments with their values in addition to making a financial return. Specifically, charitable trusts and foundations may be able to now generate greater impact by combining the efforts of their investment and grant-making activities.
- Communities – disadvantaged areas now have the opportunity to access greater capital to develop services, build infrastructure and create sustainable employment where the social outcomes are valued, as well as the financial.
- Non-profits and social ventures – can now access aligned capital to scale the scope of their services and deliver greater impact .
- Government – can better target and utilise public money and demand greater accountability for outcomes, unlocking more capital that can be used to benefit society.

A COMPELLING OPPORTUNITY FOR CHARITABLE TRUSTS AND FOUNDATIONS

Australian charitable trusts and foundations are well positioned to leverage the compelling opportunity that impact investing presents. Where consistent with their Deeds, through deploying part or all of their corpus into impact investments, trusts and foundations can engage with a greater set of solutions to social and environmental challenges; and amplify the positive impact they wish to have on society (domestically and/or globally) in addition to generating a financial return.



Impact investing challenges the whole notion of philanthropy. It asks, ‘what does it take to deploy capital in a way that is positive?’ It is a huge opportunity to change the status quo.

– Lisa Kleissner, KL Felicitas Foundation



To be clear, impact investing is not a replacement for philanthropy. It should be considered an additional ‘tool in the toolbox’ of charitable trusts and foundations to maximise their impact.

By undertaking an impact investment strategy as a charitable trust and foundation you could further its purpose and:

Amplify your impact

- Deploy a greater proportion of capital resources in support of your mission
- Direct and attract additional capital to social and environmental needs
- Strengthen community capacity
- Scale community strategies

Strengthen your foundation's influence

- Build deeper relationships with aligned people
- Protect stewardship and reputation

Support the growth of the impact investment market

Strengthen foundation's investments

- Diversify investment strategies and risk and return
- Sustain and grow assets for future use

Source: Adapted from Charlton et al and Community Foundation Field Guide

“

When I started actively managing my family foundation, I began with ethical investing. However, this lacked a bit of substance. I wanted my foundation's corpus to be able to create the most impact, and impact investing was the best way to do this.

– John McKinnon, McKinnon Family Foundation



”

It makes intuitive sense for charitable trusts and foundations to strive to create a positive social and environmental impact with their corpus in addition to their grants. Foundations are set up for a positive societal purpose, so arguably a foundation should not be contributing to, or even causing, societal problems through its investments that the same foundation might be trying to solve through its grants. Trustees may seek the opinion of its beneficiaries and take into account social, ethical and environmental issues, however this in itself cannot justify reducing financial advantage to the trust.¹⁸ In rare cases, the subject of a profitable investment is so inconsistent with the views on moral and social activities strictly held by adult beneficiaries. For example, in *Harris v Church Commissioners for England*, where the objectives of a charity conflicted with investments of a particular type, not investing in such an opportunity was held to not be a breach of trust.

“Impact investment enables a foundation to deploy a greater proportion of its assets in support of its social outcomes whilst sustaining the integrity of the foundation's corpus. The Foundation has taken the rationale that impact investments provide additional value to the social impact toolkit of the MLC Community Foundation....In our case, impact investing enables the Foundation to further deploy capital resources in support of the mission of improving mental health outcomes.”

– Luke Branagan, MLC Community Foundation

An impact investment strategy allows charitable trusts to **align the values of their investment strategy with their grant making strategy**. If they choose, foundations can intentionally seek out impact investments (mission related and program related impact investments) that directly advance the mission of the organisation.

Additionally, trusts and foundations can use grant making in conjunction with their investment strategy to develop early stage impact investment opportunities.¹⁹ For example, a foundation may make a seed grant to help a social enterprise with a pilot program to prove their model, and then once they have revenue, make a loan to the social enterprise out of their corpus to help them scale the program.

STREAT was founded in 2009. It is a social enterprise that is based in Melbourne, which provides marginalised youth with the life-skills support, work experience and training needed to enter the hospitality industry. It essentially aims to break the cycle of youth disadvantage.

In 2012, as STREAT was looking to expand, it acquired the Social Roasting Company (SRC), which had two operating cafes, as well as a coffee roasting business in Melbourne. However, this investment required financing, with the chosen form to be equity. STREAT managed to attract four investors namely Donkey Wheel, Small Giants, the McKinnon Family Foundation, and Fair Business, amounting to the \$300,000 of required capital. Both Donkey Wheel and the McKinnon Family Foundation are Private Ancillary Funds (PAFs) that were investing from their corpus.

For John McKinnon, it was important to receive a minimum return of 5%, however he was hoping for approximately 7%. In addition to McKinnon's \$50,000 equity investment, he also made a \$50,000 grant. The logic behind this was that grants should be located alongside where the corpus in order to increase the effectiveness of both and to obtain maximum leverage from each component.

There are several key lessons from STREAT's acquisition of the SRC. Firstly, equity financing was not only effective in raising the required \$300,000, but it allowed STREAT to expand with reduced risk. Additionally, since investors have an ownership stake in the company, STREAT is able to leverage their expertise. Thirdly, using both the corpus and disbursements of PAFs can enhance their overall social impact.

Where consistent with a Foundation's purpose, granting can also be used to develop the impact investment market in Australia. Currently, the expertise and infrastructure that is required for an efficiently functioning, mature market is not in place. Philanthropic grants should continue to play a role in developing the required infrastructure for growing the impact investment market in Australia.²⁰ This can involve support of investor, investee and advisor education and capacity building, development of investment platforms, rating systems and agencies that help move the market to maturity.

Catalytic impact investment by charitable trusts and foundations represents one of the most powerful opportunities to maximise and leverage impact by attracting additional flow of capital from mainstream investors to social and environmental solutions. Early stage investment from charitable trusts and foundations can build credibility and de-risk investment opportunities that would have previously not have attracted mainstream investors. Further, impact investment by charitable trusts and foundations can also be used to build volume and credibility in organisations and businesses.

“ Critics often judge that grant capital should be used purely for social benefit and investment capital should be maximized to increase or maintain the corpus or pool. However, I do not believe that they are mutually exclusive. All investments carry risk and return, hence if you are prudent in an investment, you can receive a good financial return, and reap the bonus of quantifiable social outcomes.

– Luke Branagan, MLC Community Foundation



OVERCOMING PERCEIVED BARRIERS TO IMPACT INVESTING

Despite the intuitive rationale of impact investment for charitable trusts and foundations, only a few early movers have adopted the approach in Australia, although there are many more internationally. The absence of practical guides and examples have meant many Trustees natural reluctance to experiment beyond the tried and true execution of their fiduciary responsibilities. There are also a number of common myths and perceived challenges that have precluded charitable trusts and foundations from active participation in the impact investment market.

Some of these common myths and challenges are addressed in the report *Impact Investments: Perspectives for Australian Charitable Trusts and Foundations*²¹ and are explained below:

PERCEIVED BARRIER

Navigating Investment Duties of Charitable Trustees | Trustees of Australian charitable trusts and foundations may be uncertain about how to navigate their legal and investment duties and are wary that engaging in impact investments may be a breach of their fiduciary responsibilities to “be primarily concerned with the financial advantage of the trust.”²²

RESPONSE

Whilst such caution is appropriate, with care, the requirements imposed on trustees can be navigated in a way that permits the trustees to provide capital to enterprises and funds that pursue a social impact agenda. There is no difficulty with finance first impact investments, as they deliver a risk adjusted commercial return with the bonus of social impact. There may be challenges with impact first investments where there are discounted returns, depending on the structure. To pursue these there needs to be explicit alignment with the Trust purpose as set out in the Deed. [Also see the response to the next barrier].

Ambiguities about discounted returns counting towards minimum distribution requirements |

Currently, Example 3 in Rule 19.3 in the *Public Ancillary Fund Guidelines 2011* (Cth) states: “If a public ancillary fund invests in a social impact bond issued by a deductible gift recipient with a return that is less than the market rate of return on a similar corporate bond issues, the fund is providing a benefit whose market value is equal to the interest saved by the deductible gift recipient from issuing the bond at a discounted rate of return”.²³ This example was explicitly added to the 2011 PuAF Guidelines to provide clarity as it was not included in the 2009 PAF Guidelines, causing some uncertainty.

Guidelines 19.3 in both the PAF and PuAF versions are identical. The underlying legislation is about Ancillary Funds making no distinction between the two forms. It is understood the Government will shortly add this example to the PAF Guidelines to remove any lingering uncertainty.



Term confusion and understanding where impact investing sits in the portfolio |

Differing definitions and philosophical approaches to impact investment have created confusion and uncertainty about where impact investing sits in the modern portfolio and how much to allocate to impact investments.

Whilst some argue that impact investment is an emerging asset class, the increasingly recognised view, endorsed by the Global Impact Investment Network (GIIN) and World Economic Forum (WEF) is that impact investment is a ‘lens’ that can be applied across mainstream asset classes. This is the definition that is adopted throughout this guide. Taking the integrated approach, Australian charitable trusts and foundations can apply an impact investment strategy to part or all of their investment portfolio, across all or selected asset classes.



PERCEIVED BARRIER

Uncertainty around achieving competitive financial returns as impact investments are higher risk | There is currently a perception in the market that impact investing necessitates both a high risk appetite as well as a financial trade-off. Despite sound financial returns in impact investments, there is a limited amount of public information that is published, hence creating scepticism.

RESPONSE

Although there is only a short track record of impact investing in Australia, most of the investments to date have achieved competitive financial returns. See table on p 20-21 for further detail on select Australian investments. There is no evidence that shows that impact investments have a higher financial risk than mainstream investments – there are investments at all points on the risk spectrum. However, there is an additional type of risk – impact risk. There is risk that the forecast impact may not materialise, or the investment may have unintended impacts.

Accessing Expertise and Lack of Efficient Investment Infrastructure | Due to the relative immaturity of the Australian market, there are a limited number of impact investment experts and few resources that can help charitable trusts and foundations design and implement an impact investment strategy. The nature of impact investing requires market knowledge and expertise both on the financial side and on the social and environmental side. Further development of an investment infrastructure encompassing advisors, fund managers and product developers is required to accelerate participation in the market and drive down high transaction costs caused by fragmented supply and demand, complex deals and limited understanding of risk.

As the market for impact investment in Australia matures, the pool of specialist consultants and intermediaries will grow, as will the impact investment infrastructure. This Guide seeks to consolidate the existing resources available in Australia as a step to improving the intermediation and infrastructure (see p 59 for a list of intermediaries).



Sourcing Deals, Limited Absorptive Capacity for Capital and Lack of Track Record

Australian charitable trusts and foundations cite lack of deal flow as a barrier to participating in impact investments. To date, most deals in Australia have been bespoke individual investment opportunities that present limited scale, liquidity and diversification. Also, the limited number of funds and products that are available domestically are yet to demonstrate a reputable track record to be included on approved lists for mainstream wealth advisors to recommend to their clients.

Although there have been a limited number of products available to date, the numbers of deals is growing rapidly. Also, charitable trusts and foundations may also have the ability to partner with previous grantees or others to develop their own impact investment opportunities. See p 59 for a list of funds managers in Australia.

Trust Deed requires capital to be held in perpetuity and income to be distributed for one or more charitable purposes | Where the deed (or in many cases Wills that are the founding documents of the charitable trust), require the capital to be held in perpetuity, there is a constraint on all but finance first impact investments.

This barrier generally only applies to will trusts.

PERCEIVED BARRIER

Managing Risk and Adapting Mainstream Investment Decision Frameworks

Investment decision frameworks for impact investments not only need to assess financial risk and return, but also the social risk (intended and unintended consequences) and return (the impact). There are currently limited frameworks to assist the investment committee assess social impact.

RESPONSE

Adopting the integrated approach enables established investment decision-making frameworks, due diligence processes and portfolio construction models to be applied to an investment portfolio that includes impact investments. There are emerging frameworks that provide a basis for developing and implementing an impact investment strategy across all or part of the portfolio. These frameworks guide investors to establish portfolio parameters, define and investment strategy and asset allocation targets, determine an impact thesis, assess investment opportunities for risk, return and impact and manage financial and impact risk (see p 41-52 for more details; see Appendix 2 for sample frameworks)

Classification of PAFs as sophisticated or professional investors | Currently, some PAFs are unclear whether they meet sophisticated or professional investor tests under the exemptions from the prospectus regime, despite very high net worth individuals or organisations having established them.²⁴ Many impact investing funds or social benefit bond offerings can only accept investors if they are sophisticated investors. Refer to p 40 in regards to whether a trust is a sophisticated investor. The threshold to be considered a sophisticated investor is \$2.5 million and the average PAF has asset values in the \$2-3 million range,²⁵ so the definition of sophisticated investor serves as an impediment for some PAFs to participate in impact investment offerings. There is also legal ambiguity in interpreting the legislative provisions relating to whether a PAF meets the sophisticated investor test.

The principal responsibility for ensuring this rests with the issuer, but there would be benefit in ASIC providing regulatory guidance directed at PAFs which clarifies the operation of the relevant provisions of the *Corporations Act 2001* (Cth) or legislative reform. A number of submissions to the Murray Financial Systems Inquiry made this suggestion. This would enable the PAF to be confident in accessing a greater number of investment offerings.



Many impact investments require patient capital and have limited liquidity | Investors believe that their capital is 'locked up' for a long period of time when they take part in impact investing and that this limited liquidity is problematic.

Just like mainstream investments, there are impact investments that have both short and long time horizons. As the market is less developed, it is acknowledged that there is generally less liquidity. However, most charitable trusts and foundations are set up to exist in perpetuity. As long as the investment is generating sufficient income each year to distribute in grants (5% for PAFs and 4% for PuAFs), arguably a charitable foundation should be prepared to wait for the return of their capital. Charitable trusts and foundations are often most able to be patient compared to other legal structures, and the case for doing so is greater when the investment pursues impact in addition to financial return. In fact, because of the enhanced returns often available from illiquid investments, having a proportion of a portfolio in illiquid investments is actually an opportunity to increase the return.





PART 3 | GETTING STARTED



There is no single right way to get started with impact investing. It takes time, commitment and a willingness to just ‘give it a go’. Some of the trusts and foundations in Australia started by executing a deal, then reflecting on their impact investment policy later; others spent considerable time drafting policies and procedures and are now actively engaging in the market in accordance with their strategy. Designing and activating an impact investment strategy is more likely to be an iterative than a linear process. This is discussed at length in Part 4. It is generally best to start by checking the Deed of your Trust to see what it allows.



When I started impact investing, the market was so young so I didn't speak to many people. For new impact investors, my advice is to find an established impact investor, pick his or her brain and get the lay of the land!

– John McKinnon, McKinnon Family Foundation



In addition, all Australian charitable trusts and foundations require valid internal buy-in from the trustees, so this is also a good place to start. Some foundations are small and family run, whilst others foundations are managed by an executive team and a board of trustees not directly connected to the wealth.

The steps below provide a preliminary guide for how trusts and foundations might consider getting started with impact investing:

1. **Navigate your legal requirements** – understand the legal framework that you operate within including the contents of the trust deed, common law trustee duties and the investment policy
2. **Articulate the mission, values and objectives** of the charitable trust
3. **Meet other investors** – network and interact with peers who have experience making impact investments
4. **Perform a baseline assessment** – where is the charitable trust's investment portfolio now? Is there a need to divest any investments that are in conflict with the mission and values?
5. **Get consensus to devise an impact investing strategy and/or make a test investment** – source the first investment in an area you are passionate about and begin making the transition to a portfolio of impact investments

“We started impact investing in 2009 as we wanted to double our impact by using our corpus to affect change. It wasn't until 2012 that the market was developed enough for us to draft an impact investment strategy.”

– Cathy Truong, Trawalla Foundation

“The MLC Community Foundation started by understanding the Australian and global market place, creating an evaluation framework utilising commercial investment principles, allocating a portion of investment capital to pilot impact investments, setting risks and returns on both financial and social dimensions, and evaluating all transactions using prudent person principles.”

– Luke Branagan, MLC Community Foundation

WORKING WITHIN YOUR LEGAL STRUCTURE

It is important to firstly understand the legal structure of a particular trust or foundation, as this will determine whether there are constraints (which may be addressed by a change in the trust deed if that is allowed) or it is necessary to implement a formal investment policy. The table below summarises the three most commonly used legal structures:

	PRIVATE & TESTAMENTARY CHARITABLE TRUST	PRIVATE ANCILLARY FUND (PAF)	PUBLIC ANCILLARY FUND (PUAF)
DESCRIPTION	Established by trust deed or will. Does not come into operation until after the founders death or through a trust deed. Deed or will establishes a charitable purpose.	Established by will or Deed instrument; tax deductible donations allowed; cannot solicit funds from the public.	Established by will or express instrument; tax deductible donations allowed; allowed to solicit funds from the public.
RELEVANT LEGISLATION	State-based trust legislation; specific charitable trust legislation,	<i>Private Ancillary Fund Guidelines 2009</i> , State-based trust legislation; specific charitable trust legislation	<i>Public Ancillary Fund Guidelines 2011</i> , State-based trust legislation; specific charitable trust legislation
NATURE OF TRUSTEES	Individuals or corporate trustee	Private trustee company, an incorporated association and/or a Statutory Trustee Company; different to the earlier Prescribed Private Funds and other charitable trusts which allow individuals to be trustees; existing PPFs with individual trustees can continue with individuals as trustees	Private or public company, an incorporated association, a Licensed or Public Trustee; existing PuAFs with individual trustees can continue with individual trustees (including replacement of individual trustees)
RESPONSIBLE PERSONS AS TRUSTEES	N/A	Trustees/Directors must include at least one 'responsible person' (someone with a degree of responsibility to the community but he/she must not be associated to the founder or donor)	Majority of individuals as directors/trustees must have a degree of responsibility to the community at large
INVESTMENT POLICY REQUIRED?	Recommended	Yes	Yes

If you are unsure of your legal structure, you can check ABN Lookup, the public view of the Australian Business Register: abr.business.gov.au.

For further detail, please refer to the Philanthropy Australia Trustee Handbook on the role and duties of trustees of charitable trust and foundations in Australia by David Ward.



LEGAL STRUCTURE OF TRUSTS

Trustees may want to consider a series of questions about their trust’s current legal structure. Furthermore, individuals who are looking to set up a new charitable trust may want to consider these questions, so that their trust deed will allow impact investments to be made. The considerations can be broken down into a number of steps:

- Step 1:** Examine the trust deed to determine whether there are any potential restrictions regarding impact investing;
- Step 2:** Understand trustees’ legal duties to administer the trust in accordance with the trust deed;²⁶
- Step 3:** Consider whether the trust or Trustees are classified as a sophisticated investor under the relevant corporation laws;
- Step 4:** Construct an investment policy (see part 4 of this Guide for further assistance with this); and
- Step 5:** Consider the role of fund managers.

Appendix 5 contains a more comprehensive break down of each step.

GAINING CONSENSUS

Gaining valid consensus amongst the trustees or the board of directors is crucial. The table below highlights some of the common barriers to getting internal buy-in and some suggested solutions:

COMMON BARRIERS	SUGGESTED SOLUTIONS
<ul style="list-style-type: none"> • Different generational attitudes and beliefs 	<ul style="list-style-type: none"> • Use external advisors to validate the merits of impact investing impartially • Pilot portfolio to ‘test the waters’ • Attend workshops, build awareness
<ul style="list-style-type: none"> • Financially driven and concerned about return on investment 	<ul style="list-style-type: none"> • Speak financial language and consider finance first impact investments (where there is a risk adjusted market return)
<ul style="list-style-type: none"> • There is no track record • Most of the investments are not liquid and require patient capital 	<ul style="list-style-type: none"> • See above – Section 2 Overcoming Perceived Barriers to Impact Investing

Depending on the various trustee entities, there are different consensus requirements and legal boundaries that are applicable.

Where Trustees of a charitable trust are individuals a simple majority is required to make a decision. If the Trustee is a corporate entity, the decision making rules of that entity apply which are usually a simple majority. However, where embarking on a new line of activity as significant as impact investing, it would be desirable to have all Trustees or Directors agree to the policy shift. Please refer to the Philanthropy Australia Trustee Handbook for further detail about consensus requirements.

DEVELOPING THE RIGHT INFRASTRUCTURE AND LEVERAGING EXPERTISE

Designing and implementing an impact investment strategy requires an honest assessment of existing internal infrastructure and staff capacity to determine if external support is required. A trustee or foundation that has no demonstrable expertise in impact investing, or perhaps inadequate resources, would probably be expected to seek advice as a consequence of the duty of care it owes. Sometimes charitable trusts and foundations already have a team of financial advisors and asset managers to help manage their investments and the foundation and advisor enter the impact investment journey together. Some trusts and foundations have encountered resistance to impact investment from their traditional or existing advisors and have made the decision to source new advisors who are experienced with impact investing or at least values-aligned. Depending on the level of understanding of impact investing concepts, external support from experienced financial consultants and investment advisors positioned to help develop and execute the strategy can help to ensure the success of an impact investing strategy.²⁷



When we started the Foundation, we needed to source an external trustee. Our existing financial advisor was happy to serve as trustee. Beyond this, we didn't need any other expertise beyond myself and my wife, Sue. I think it is crucial that external people that are involved have a strong value alignment with the foundation.

- John McKinnon, McKinnon Family Foundation



Approaches taken by charitable trusts and foundations can vary from informal 'ad hoc' investments to highly structured and formal processes spanning part of, or the entire portfolio. Some larger organisations may establish a separate portfolio within the investment team, while others have elected to bring the entire organisation in line with their impact mission by creating a single team to manage both their grant making and investment activities using a "whole institution" approach.²⁹ This has the advantage of ensuring both financial and social returns are considered and can be highly valuable for attaining trustee approval on the initial impact investing strategy and subsequent investment opportunities. For example, the FB Heron Foundation use a "whole institution" approach in which they have created a single team to manage both the grant making and investment activities of the foundation.



When KL Felicitas moved away from negative screening and responsible investments towards impact investments, we made the strategic decision to hire a team of advisors rather than rely on any one consultant or firm to provide full services, which culminated in the creation of a multi-disciplinary team.²⁸

- Lisa Kleissner, KL Felicitas Foundation



The size and objectives of the program, level of expertise and desired engagement will help to determine whether external support is needed. The table below outlines some key questions that can help guide the decision to 'go it alone', build a team internally or work with external advisors:

Assessing internal structures, processes and staff competencies:

- What is the objective of the impact investing program? To 'test the waters' or to 'implement a full strategy'?
- What is the size of the impact investment program?
- What is the timeframe and level of commitment required from trustees and staff to implement an impact investment strategy?
- Is my existing team of advisors experienced with impact investment? Values aligned with impact investing? Willing to engage in this form of investment?
- Is a single person or a team required? Will it be an advisor or a fund manager?
- Who should be driving the strategy?
- How will the organisation staff, partner or outsource the following:
 - internal education, deal sourcing, financial due diligence, legal structuring and documentation, deal negotiating and closing, portfolio monitoring and reporting human resources and systems for financial performance, social impact, evaluation, reporting and communication?
- Will you outsource the liquid part of the investments to an external manager/advisor or outsource the entire strategy implementation and maintenance to an external specialist?

Source: Adapted from JB Jaquier, Guide to Impact Investing for Family Offices and High Net Worth Individuals, 2011

How and when to use advisors

Advisors can be extremely useful at different stages in the development and implementation of the impact investment strategy. This will depend on the needs and skills gaps of each individual organisation. Smaller foundations, which lack the internal capacity, may elect to outsource some or all of these steps. Some larger foundations that already have an internal investment team in place may elect only to outsource the development of the strategy and policy and impact evaluation.

Advisors can be used in some or all of the following stages of the impact investing journey:³⁰

- Introduction to impact investing concepts and terminology
- Development of an impact investing strategy and policy
- Implementation of the impact investing strategy including asset allocation and thematic selection, sourcing investment opportunities, conducting due diligence, and managing of the portfolio
- Personal 'coaching' in deal making including structuring and analysing investments, company valuations, deal documentation and monitoring

The table below outlines the advantages and disadvantages of various approaches charitable trusts and foundations can use to design and implement an impact investment strategy.

APPROACH	ADVANTAGES	DISADVANTAGES
Do it yourself	<ul style="list-style-type: none"> • Lower costs • Control of setting vision and implementing strategy • Ability to act quickly • Can 'test the waters' • 'Learn by doing' 	<ul style="list-style-type: none"> • High degree of complexity and broad choices • Significant time and effort
Build a team internally	<ul style="list-style-type: none"> • Leverage expertise and experience • Useful for trustees/staff who are busy or want to be less engaged in the implementation • Useful for trusts/foundations with a specific interest in an impact area or geography • Save time building capacity of existing staff • Ensure alignment with values and mission 	<ul style="list-style-type: none"> • Costs of hiring and maintaining dedicated staff/team – prohibitive for many small foundations • Slower learning curve for trustees • Sourcing expertise in Australia is challenging
Access external expertise (use existing advisors or source new impact investment expertise)	<ul style="list-style-type: none"> • Leverage expertise and experience • Independent third party can play a mediating role in gaining internal consensus • Reduce ongoing costs by paying for services only when required • Save time and effort by outsourcing implementation • Can play a 'coaching' role in impact investment • Conducting due diligence on specific deals 	<ul style="list-style-type: none"> • Consulting costs • Slower learning curve for trustees • Risk of mission drift if want to engage in mission investing • Sourcing expertise in Australia is limited

SOURCING EXPERTISE

If the decision is made to access support in designing and/or implementing an impact investing strategy, the key is to source and select appropriate internal staff and/or advisors to deliver what they are mandated to execute. Whilst impact investment is still a relatively new concept in Australia, there are now a number of mainstream financial institutions, wealth advisors and consultants that are developing competency and understanding in the field.³¹

It is important for foundations to be clear about their intentions when consulting external expertise to ensure that the chosen advisor is aligned with the foundation's values, meeting desired standards and respecting the objectives and the constraints of the strategy. Strong financial expertise is obviously important, however foundations may seek an advisor with specific impact area or geographical expertise. Impact investment requires financial expertise together with programmatic expertise in the targeted social or environmental areas, as well as the ability to understand and work with diverse sets of stakeholders across the social, public and private sectors.³²



We rely on our advisors. We only consider overriding the opinion of our advisors if we think the impact could be catalytic. Any financial due diligence process would flag first time funds as very risky. This makes it very hard for first time fund managers to raise capital. We support first time fund managers particularly if we know the persons behind it and if we trust them to figure it out. If we think their fund is innovative and could be catalytic for other capital, then we would make the investment. An example of this was our investment in Aquaspark, of approximately €100,000.

It is a unique fund that looks at best of breed in aquaculture globally. We are interested in the health of the oceans and there are few products addressing this. Fisheries are also traditionally invested in by people in the industry and there are little to no fund products that allow individuals to do a direct investment.

– Charly Kleissner, KL Felicitas Foundation



The table below provides a list of select organisations and resources that can help connect Australian charitable trusts and foundations to appropriate expertise. Also see the Sourcing Investment Opportunities section in part 5 for examples of Australian funds and Intermediaries that may be useful for foundations entering this new market.

SOURCE	DOMESTIC	INTERNATIONAL
Independent Advisory Practice	Australian Impact Investments Australian Ethical Ethinvest	Imprint Capital (now part of Goldman Sachs)
Asset Managers	Impact Investment Group Social Investment Australia	Calvert Foundation RSF Social Finance BlueOrchard Sarona
Multi-family offices	Myer Philanthropic Services	Springcreek Advisors Shaperpa Quadia
Banks	JBWere NAB Private Wealth	JP Morgan Triodos Bank
Websites listing advisors	Australian Ethical Responsible Investment Association Australasia	ASrIA Calvert Foundation Investors' Circle Mission Markets Artha Platform



PART 4 | DESIGNING AN IMPACT INVESTMENT STRATEGY



An impact investment strategy is essentially a clearly defined plan charitable trusts and foundations follow to achieve their impact and financial objectives with their investments. The strategy is a framework to guide trustees in making their investment decisions and meeting their duties, and to help executives in operating the foundation.



We invest our financial capital, our intellectual capital, our networks, ourselves, into businesses that share our values

– Danny Almagor, Small Giants



Legally, trustees of all PAFs and PuAFs must formulate and adhere to an investment strategy,³³ and best practice is for all foundations to formulate and adhere to an investment strategy. The strategy should set out the investment objectives of the fund and detail the investment methods the trustee will adopt to achieve those objectives.³⁴ The strategy must reflect the purpose and circumstances of the fund and have particular regard to (but not be limited to):

- the risk involved in making, holding and realising, and the likely return from, the fund's investments, having regard to the fund's objects and its expected cash flow requirements (including distribution requirements); and
- the composition of the fund's investments as a whole, including the extent to which the investments are diverse or involve the fund being exposed to risks from inadequate diversification; and
- the liquidity of the fund's investments, having regard to its expected cash flow requirements (including distribution requirements); and
- the ability of the fund to discharge its existing and prospective liabilities; and
- the investment requirements imposed by State laws or Territory laws.³⁵

It is possible for impact investing to be incorporated into an existing investment strategy . An impact investment strategy does not need to be created from a 'blank slate'. It just usually entails additional considerations in relation to impact.

In fact, many of the investment management practices discussed in this section are used in mainstream financial investments. They have just been modified to reflect an impact investing lens.

The impact investing strategy can be developed internally among trustees and/or executives or with the help of external advisors. See part 3 for a discussion of external advisors. This decision requires a careful examination of existing capabilities and desires in relation to the level of participation in the process.

This part is broken down into the following stages of designing an impact investing strategy:

1. [Determining your intended impact](#)
2. [Define investment objectives and portfolio parameters](#)
3. [Set asset allocation targets](#)
4. [Develop a framework for risk, return and impact](#)

Although there are other questions to consider such as how involved you want to be, these are addressed elsewhere in the Guide.

If you don't want to go through all these stages in detail, here are some key questions to consider:

1. Why do you want to impact invest? Does profit, impact or a mix of both drive you?
2. What impact do you want to achieve? Is there a particular cause, issue, or issues you want to address? Does it need to relate to your grant strategy?
3. What are your financial return expectations?
4. What are your strengths and limitations?
5. How engaged do you want to be?
6. How much of your portfolio do you plan to allocate to impact investing?
7. Do you have any liquidity constraints/considerations? What is your time horizon?
8. Do you want to focus on a particular asset class or invest across asset classes?
9. Do you plan to do direct investments or invest through a fund?
10. How do you intend to measure impact?

Source: Adapted from JB Jaquier, Guide to Impact Investing for Family Offices and High Net Worth Individuals, 2011

1. IMPACT OBJECTIVES: ARTICULATING INTENDED IMPACT

One of the first things to consider when designing the strategy is the intended impact. This can be approached a number of ways and in varying levels of detail.

Do you have any impact goals? If so, what are they?

Within the purpose of the Trust as set out in the Deed your goal could be very broad such as “doing good” generally in whatever ways are possible. Alternatively, you may have a specific social or environmental goal.



We are agnostic as to issue area. We ask: is this good for people, is it good for the environment, is it creating the world we want to live in? If it's NO to those then it doesn't get through our first filter

– Danny Almagor, Small Giants





Where do you want to make an impact?

This could be broad or narrow. Do you want to focus on your local community? Australia? Developing countries?

Do you want to have the greatest impact possible?

To have the greatest impact, it might be necessary to actually do a gap analysis to identify the most pressing needs. It is possible to set an impact 'floor' – a minimum amount of impact that the investment must generate in order to meet your criteria.

Do you currently ethically screen any investments?

On the most basic level, a trustee may want to prohibit investments that are contrary to the charitable trust's purpose. This is not impact investing, but ethical screening could be considered a pre-cursor to impact investing.

The investment policy may not need to adopt an exclusionary policy, but individual investments may be excluded if perceived to conflict with the charitable trust's purpose. Alternatively, trustees may want to implement a negative screening that mandates for the avoidance of certain investments. Fund managers such as Australian Ethical disallow investments in companies that for example, unnecessarily pollute the environment or deal with a product or service that has a harmful effect on consumers.³⁶

The investment policy may additionally adopt positive screening strategy, where trustees are proactively searching for investments that could positively contribute to society or the environment. This may be an intermediate option for trustees not ready to pledge their corpus to impact investing, while at the same time, would like an effective way to support investments and businesses that are creating positive social return.

Do you want your investment strategy to relate at all to your grant strategy?

Whilst this makes sense ultimately, sourcing enough impact investment deals that align with the grant strategy can be a problem. Other trusts and foundations may centre their impact investing approach around key program areas (program-related investing).

Do you want your investment strategy to align with your specific mission?

Some trusts and foundations may choose to align their impact investment strategy with the mission of the foundation (mission-related investing).

It is not imperative that the investment strategy be directly related to the organisation's mission or programs, although as explained elsewhere, if there is a financial return trade off due to the social impact, it must be aligned with the charitable purpose of the Foundation.

Making a firm commitment to a strict alignment with a specific mission in the current Australian climate can be a barrier due to lack of deal flow. To date, most of the charitable trusts and foundations in Australia have just decided to 'dip their toe in the water' and make impact investments not strictly aligned with their mission, simply to start gaining experience in the impact investment market.

Below are three examples showcasing the varying extent to which investment strategies can relate to the specific mission of the foundation. The purpose of the deed of the two Australian foundations - the McKinnon Family Foundation and the MLC Community Foundation - is to benefit eligible entities.

	THE MCKINNON FAMILY FOUNDATION	KL FELICITAS	THE MLC FOUNDATION
FOUNDATION MISSION	The McKinnon Family Foundation has a relatively broad mission focusing on three main areas: 1. environment 2. poverty alleviation 3. social enterprise development	KL Felicitas mission is to support social entrepreneurs and enterprises worldwide to grow sustainably and to deploy their capital to create positive change and address major world problems.	The MLC Foundation's mission is to support mental health endeavours.
INVESTMENT STRATEGY	The McKinnon Family Foundation is a Private Ancillary Fund and they are able to make investments in a range of different areas that would all fall within the broad scope of the foundation's mission.	The Kleissners' overall investment strategy is guided by their mission and core values of transparency and accountability but they make both finance-first and impact first investments.	MLC Foundation's investment strategy is aligned with its philanthropic mission. The advantage of this approach is that it ties the impact investment and subsequent social outcomes directly to mission. However, due to the small scale of the impact investment market in Australia, it has been challenging to source impact investments that directly relate to their mission.

2. DEFINE INVESTMENT OBJECTIVES AND PORTFOLIO PARAMETERS

Articulating an investment objective

A common characteristic of successful investment organisations is that they are able to clearly define their investment objectives and articulate principles that they will follow in seeking to achieve their objectives.

The investment objectives will depend on an individual trust's aims, operating model, timescales and resources. A charitable trust must be clear on what it wants to do and the investment objective will articulate how the trust can go about doing so.

For example, a trustee may consider different investment objectives for different needs:

- Immediate distribution needs may induce a charitable trust to aim to maximise immediate income
- A charitable trust with large future commitments may induce a trust to preserve the real value of capital and source investment opportunities for potential growth
- A charitable trust with a long-term purpose may need ongoing, stable income

Consider explicitly mentioning impact in the investment objective. If you have decided to focus your investments in areas of your mission, you should consider including in the trust's investment objective furthering the aims of the trust or foundation.



Setting targets for financial returns

The financial returns can vary from concessionary to highly competitive, so deciding where you want to sit on the spectrum is an important part of creating your impact investing strategy.

If you are incorporating impact investing into your program strategy, you may be more willing to trade off financial return for social impact. Onerous financial targets and benchmarks may discourage impact investing with lower financial return.



The MLC Foundation evaluates investments above respective financial and impact floors, taking into consideration the interrelations and dynamics amongst those parameters.

– Luke Branagan, MLC Community Foundation



The structure of your trust or foundation may also influence the target for financial return. As PAFs need to distribute 5% of their net assets each year, the target for financial return needs to be at least 5% if the size of the fund is to be maintained. The target may need to be 5% plus CPI capital growth if the fund is to be maintained in real terms. On the other hand, a will trust or private charitable trust is only obligated to give away the income it receives each year, so the trustees have more flexibility in balancing income compared to capital growth.

Setting a benchmark

Trustees may want to adopt a financial benchmark in which the trust can compare its returns to. A benchmark can be any financial metric that can be appropriately aligned to the investment objective of the charitable trust. For example, Australia's Future Fund adopted an average return of at least the Consumer Price Index plus 4.5% to 5.5% p.a. over the long term as the benchmark return on the Fund.³⁷

Time horizon

How patient are you prepared to be?

A trustee may want to include in this section the expected time horizon of the charitable trust's investments. The time horizon should align with the objectives of the trust. As charitable trusts often exist into perpetuity, investments should be managed to meet this long term objective. Hence, setting an investment policy that allows for long-term investments may be quite appropriate.

In investing in earlier stage impact investments, it may be the case that the capital may face a long investment period, with a payback in seven to ten years. This concept is known as patient capital and should be a consideration when investing, especially in direct investments. However, there is merit as it provides the capital required to nurture an enterprise to fruition and to thus create a greater impact.

"I think it comes back to part of the asset allocation process. We would think of most impact investments being of a private equity nature in terms of timeframe (and probably valuation as well). So part of a portfolio would be available for very long term patient capital. This also suggests there is a place for some short term, more capital stable impact investments, probably in the shape of debt rather than equity."

- John McLeod, PAF

Liquidity

Articulate what type of liquidity you need. Are you able to invest in illiquid assets?

Given the lack of any formal exchange on which the impact investments can be traded or brokers that can facilitate deals, impact investments will be relatively more illiquid when compared to traditional financial investments. However, the investments can still be privately traded among the increasing base of impact investors, and with the increasing maturity of the industry, more opportunities can arise to improve liquidity and the associated valuation of investments.



Given this is an emerging market impact investments are typically not liquid. The MLC Community Foundation is therefore prepared to keep its capital invested for the life of the respective investment or a substantial time period. The multi-year timeframe was selected with this flexibility in mind.

– Luke Branagan, MLC Community Foundation



“We structure many of our deals to have structured financial exits while we get the impact so we are not tied to an exit event. We have started to do more of this – tapping into the cash flow of a company rather than waiting for an exit. Therefore, we get money back as soon as the company has free cash flow as opposed to waiting for an exit. An example of this would be our investment in BBK Waste Management (India) where we get between 8% and 15% return depending on milestones usually tied to the top-line (the revenue of the company).”

– Charly & Lisa Kleissner, KL Felicitas Foundation

Given in most circumstances a call of a Foundation’s capital is very rare indeed, taking advantage of the higher returns that are often generated from illiquid investments can be beneficial to the Foundation.

3. SET ASSET ALLOCATION TARGETS

A well-diversified investment portfolio is a method to reduce the overall risk of the portfolio, or in other words, reducing the likelihood of attaining an abnormal return from an investment. Trustees should consider including an asset allocation policy in the investment strategy to help facilitate forming a diversified portfolio.



We have a fairly standard investment policy that includes asset allocation ranges and ethical considerations. As we view impact investments as a lens over asset classes, rather than a separate asset class, we don’t have an allocation to them as such.

– John McLeod, PAF



Trustees may consider placing a restriction on total exposure on any one investment class. Overall, how the investments are split across each category should be aligned with the trustees’ investment objectives. As impact investing is a lens across all asset classes, it generally does not make sense to prohibit investment in certain asset classes.

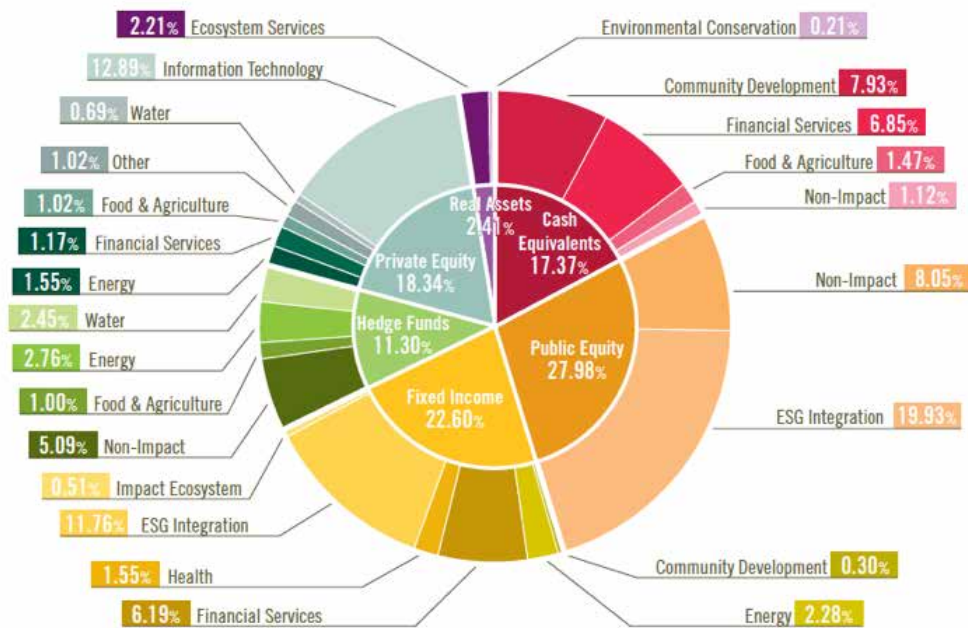


The table below summarises the key investments of KL Felicitas, offering an example of a diversified impact investment portfolio across all asset classes, although note that it is definitely possible to start impact investing in only one asset class. Refer to page 20 and 21 for Australian examples across asset classes.

By keeping the categories broad, this minimises the risk of overlooking a potentially attractive investment opportunity because it does not fit the narrow definition of an allowable asset class.

ASSET CLASS	RANGE	KL FELICITAS EXAMPLE
Stable assets		
Cash	0-10%	Cash deposits and CDs from community-focused banks, as well as quarterly liquid funds providing debt to social enterprises. Impact focused on community development and financial services.
Fixed Income	20-30%	US: agency mortgage-backed securities Global: managers supporting the development of microfinance and small and medium enterprises throughout the developing world. Impact themes include financial services (underserved populations both in the US and in emerging economies that otherwise would not have access to capital) and community development.
Growth assets		
Listed Equities	20-35%	Investments in high quality companies with robust integration of environmental, social and governance factors. Several managers use positive screens to evaluate performance in relation to climate change, improved resource productivity, employee benefits and corporate governance/transparency.
Hedge Funds	5-15%	Invested in two funds that have a primary focus on water, with a secondary focus on agriculture and energy.
Private Equity	15-25%	Investments in venture capital funds as well as direct equity and debt investments. Direct equity investments include companies involved in African agriculture and plant cultivation, Indian healthcare, community clean energy production and social campaign design and implementation. Investments in energy include a social enterprise that manufactures and distributes cook stoves globally. These stoves help reduce the toxic effects of indoor air pollution, reduce deforestation for cooking fuel and also provide a power source for small electrical devices such as lights or cell phones.
Inflation protected assets		
Real estate	0-10%	No real estate investments are known.
Real assets	5-12%	Investments primarily in ecosystem services, such as carbon sequestration or nutrient cycling, as well as enterprises that advance land conservation and sustainable forestry activities in the US.

Figure 20: KLF Asset Class Exposure and Impact



Reproduced with permission of Charly and Lisa Kleissner; extracted from Sonen Capital in collaboration with the KL Felicitas Foundation, *Evolution of an Impact Portfolio: From Implementation to Results*, October 2013, p53.

Note that private ancillary funds and public ancillary funds are not permitted to give a security over, or in relation to, an asset of the fund, although the current status of this restriction for eligible entities should be checked at the appropriate point in time.

Impact investments can be a subset of this asset allocation, so you could have an asset allocation target for traditional investments and an asset allocation for impact investments. Alternatively, you could have a fixed allocation for impact investments and not specify the asset class if it is a small part of a portfolio.



An aim to transition to a 100% impact investment portfolio means that you must adjust your investment policy to cater for it. For example, 100% impact investment may mean that there is a shift away from listed equity to a greater focus on unlisted equity, credit or property investments, thus your investment policy must reflect this.

– John McKinnon, McKinnon Family Foundation



Portfolio rebalancing

Portfolio rebalancing refers to the process of realigning the weightings of one's portfolio of assets. Rebalancing involves periodically buying or selling assets in your portfolio to maintain the original desired level of asset allocation.

As the real value of any portfolio changes during a given period of time, trustees must rebalance a charitable trust's investment portfolio in order to adhere to the asset allocation. For example, if public equities performed well during a period, this asset's weight in the portfolio may have increased above the asset allocation.

4. MANAGING RISK

Trustees should recognise, within their investment policy, the categories of risk that the portfolio faces and the proposed mitigators of these risks. The following are examples of risks that trustees, fund managers and other individuals or organisations face with their investment portfolios. These risks are known as investment risks. What risks are you prepared to take?

With impact investments, some of these risks may be greater or lower. Some impact investments, such as social impact bonds, are often uncorrelated to other investments, and this provides diversification benefits and so lowers the risk.

RISK	DESCRIPTION	MITIGATION
MARKET RISK	Market risk, also known as systematic risk, refers to the possibility for an investor to experience loss of portfolio value due to factors that affect the overall performance of the financial markets. This risk includes factors such as recessions, such as the recent Global Financial Crisis and political turmoil.	Market risk cannot be diversified away. Market risk can generally be managed by: <ul style="list-style-type: none"> • Adopting an risk profile for the investment portfolio that is suitable for the objectives of the charitable trust through analysis of individual assets • Diligent, ongoing assessment of the prevailing market environment and the risk exposure of the investment portfolio
INFLATION RISK	Inflation risk refers to the possibility that inflation occurs at a higher rate than the growth of the capital of the portfolio. This means that over time, the value of the portfolio is not maintained.	Inflation risk can be mitigated by: <ul style="list-style-type: none"> • Targeting a return of the portfolio that meets any necessary distribution requirements plus inflation over the long term • Constructing the portfolio with an awareness of which asset classes can serve as an inflation hedge, and including some inflation protected assets in the portfolio
INCOME RISK	For PAFs and PuAFs who have an obligation to distribute 5% and 4% of net assets respectively, this risk refers to the possibility that the portfolio does not generate sufficient income to meet this obligation, and therefore trustees have to draw on the capital to make their distributions.	Income risk can be mitigated by: <ul style="list-style-type: none"> • Targeting income return on the portfolio that exceeds any necessary distribution requirements • Ensuring that the portfolio is not too heavily weighted with investments that do not generate any yield (and only have capital growth)



RISK	DESCRIPTION	MITIGATION
LIQUIDITY RISK	<p>Liquidity risk refers to the inability for investments to be sold when required or the price realised is significantly different from quoted price. Trustees require liquidity in the investment portfolio to meet immediate obligations to disburse funds, per legal requirements or to rebalance the portfolio to meet asset allocation requirements. For a charitable trust, liquidity is of particular concern because liquidity in impact investing is extremely poor. Impact investing movement trends to focus on venture investing, private equity and direct lending because of the unmatched power of these investments to generate social impact, but these investments are inherently illiquid.³⁸</p>	<p>To manage a portfolio's liquidity risk, trustees can carry out the following:</p> <ul style="list-style-type: none"> • Consider the expected cash flow requirements by the charitable trust and plan for the required liquidity • Planning with a margin of safety through a minimum allocation to liquid assets or potentially through access to a credit facility • Monitor the liquidity of a portfolio
IMPACT RISK	<p>Impact risk is an additional risk that should be considered with impact investments. For an impact-first impact investment, an investment may fail to achieve the social or environmental impact that you anticipated when you agreed to trade off financial return. There is also a reputational risk if an impact investment is financially successful at the expense of underprivileged people.</p>	<p>This risk can be mitigated by:</p> <ul style="list-style-type: none"> • Detailed impact due diligence before making the investment • Ongoing impact assessment and monitoring • Active engagement in the investment
MANAGER RISK	<p>Trustees may engage external fund managers to invest the corpus of the charitable trust. Fund managers are engaged to deliver superior returns that are above the market return. However, there is the possibility that this does not eventuate.</p>	<p>Manager risk can be mitigated by:</p> <ul style="list-style-type: none"> • Careful selection and monitoring of fund managers' performance and the composition of portfolios to ensure there are no diversions from the intended investment objective
CREDIT RISK	<p>For charitable trusts, investing in credit or providing loans presents attractive opportunities to invest in social enterprises. These investments present counterparty risk, referring to a risk of the counterparty defaulting on its contractual obligations to repay either the interest on the loan and/or the principal amount.</p>	<p>Credit risk can be managed by:</p> <ul style="list-style-type: none"> • Set a maximum permitted exposure to any one counterparty • Arrange security through appropriate contractual provisions • Having a minimum threshold as to the credit rating of the counterparty

Reviewing the investment policy

Under State Trust Law a charitable trust's investment policy and performance against the objectives must be reviewed annually and investments rebalanced if required. With changing circumstances in the financial market and with the ever-changing impact investing landscape, trustees should be able to develop and subsequently add new policies, in order to promote the best way to maximise a trust's corpus.

CONSIDER TAX IMPLICATIONS

Different types of charitable trusts and foundations are eligible for certain tax concessions as they are not-for-profits and sometimes deductible gift recipients. The amount contributed to a public ancillary fund (PuAF) or a private ancillary fund (PAF) is tax deductible in the year of contribution, as opposed to when the philanthropic gifts are donated to the ultimate beneficiaries. As a result tax and charitable gifts can be strategically managed. For instance in a year of significant tax liability a lump sum may be placed into a PAF and then gifted to a charity in the following years.³⁹



The charitable trust itself is usually the vehicle that you want from a tax perspective because it is the one that is most likely to be eligible for tax concessions and deductible gift receipts. If you've got this then you've got the maximum tax benefit that you can get.

– Michael Ryland, Partner in Ashurst's Corporate Group



PAFs and PuAFs have particular distribution requirements that must be fulfilled in order to maintain their status as ancillary funds. Specifically both entities are required to distribute a proportion of the market value of their net assets – at least 4% in the case of PuAFs and 5% in the case of PAFs. In light of this it should be noted that provision of a benefit to an eligible entity on concessional terms can count towards the minimum distribution requirements of both PAFs and PuAFs. Under s19.3 of the *Public Ancillary Fund Guidelines 2011* (Cth) it is stated:

...distribution includes the provision of money, property or benefits. If the fund provides property or benefits, the market value of the property or benefit provided is to be used in determining whether the fund has complied with this guideline [that is, the fund has distributed at least 4 per cent of the market value of its net assets as dictated by s19].

To clarify the following example is given:

Example 3: If a public ancillary fund invests in a social impact bond issued by a deductible gift recipient with a return [of say 5%] that is less than the market rate of return on a similar corporate bond issue [say 7%], the fund is providing a benefit whose market value is equal to the interest saved by the deductible gift recipient from issuing the bond at a discounted rate of return [i.e. 2%].

Note that the examples in square brackets have been added.

This demonstrates that the concessional rate of return can be included as part of the 4% minimum distribution requirements of a PuAF in regard to social impact bonds. There is nothing to suggest that this principle could not be applied to other financial instruments as well, particularly since example 2 relates to leasing property.

Section 19 of the *Private Ancillary Fund Guidelines 2009* (Cth) is almost identical to the corresponding section in the *Public Ancillary Fund Guidelines 2011* (Cth) aside from the fact that there is an increase in the market value of the net assets that need to be distributed to 5%. The above stated example 3 is absent from the section. Nonetheless, example 2 (which is similar in both the PuAF and the PAF Guidelines) is an instance of a concessional rate of return counting towards the minimum distribution requirement:

Example 2: If a private ancillary fund leases office space to a deductible gift recipient at a discount to the market price, the fund is providing a benefit whose market value is equal to the discount.

Notwithstanding this lack of a third example, a concessional rate of return to an eligible entity across asset classes can count towards the minimum distribution requirements of a PAF. The key points to note is that this rule only applies to arrangements with eligible entities (ie. DGR Item 1s).



PART 5 | IMPLEMENTING AN IMPACT INVESTMENT STRATEGY



SOURCING INVESTMENT OPPORTUNITIES

Impact investments exist in many forms, across asset classes, sectors and geographies. In Australia, most products offered by intermediaries to date have been private equity, bonds, property or loan funds. Within Australia, finding and executing impact investments remains challenging. However, there are many new initiatives in the field and the industry is maturing rapidly. There are also a significant number of opportunities in our region and internationally.

FINDING OPPORTUNITIES IN AUSTRALIA

To date, there has been no central method for sourcing Australian impact investments. However, there are several organisations who are building a track record in sourcing and structuring impact investments, including specialist financial intermediaries like Social Ventures Australia and more recently Impact Investment Group, or mainstream financial intermediaries who have taken on the role, such as Evans and Partners.



Australia is still dominated by individual investment opportunities and the same group of names continues to be involved in either advising or mentoring the groups. So the easiest way is staying in contact with these groups. There still hasn't been a single dominant site or party emerge to handle this, but it will evolve over time from what we already have.

– John McLeod, PAF



In recent times, the marked increase in interest in impact investing has contributed to the growth of impact investing incubators seeking to develop social enterprises into investable businesses so that they can provide blended value. The incubators are able to lend professional and financial assistance to enterprises in their early stages and this will bolster the pipeline for more impact investments and provide greater depth to the impact investing market.

As a potential impact investor starting out, it may be helpful to join or create a local impact investing network, perhaps with other charitable trusts and foundations. This will help with a number of aspects of the impact investing journey and may also pool both financial and human capital together to be able to source investments that would remain outside the reach of a single investor.

“My earlier investments, such as Lismore Soup Kitchen, came from relationships. Sourcing of opportunities can be from word of mouth and networks”

– John McKinnon, McKinnon Family Foundation



We leverage our local and global accelerator work with social entrepreneurs, our peer network of investors and philanthropists, and our network of impact intermediary thought leaders to stay on top of investment opportunities and best practices.

– Lisa Kleissner, KL Felicitas Foundation



“The Foundation utilises its partnerships and relationships across the mental health and social sector to source impact investment opportunities.”
– Luke Branagan, MLC Community Foundation

Networks operate at varying degrees of formality, but generally have at the heart of them an ability to share investment opportunities. For trusts and foundations, it may also help expose opportunities to become involved in earlier stages of impact investing, such as providing grants for capacity building prior to or alongside an impact investment. Examples of domestic impact investing networks, and select international networks include (a full list is included on page 95 and 96):

NETWORK	DESCRIPTION
Impact Investing Network	Launched by Philanthropy Australia to bring together impact investors within Australia
Impact Club	Private Australian impact investing network by invitation only.
Impact Investment Centre at donkey wheel house, Melbourne	A place for impact investors to engage with best practice, international and domestic developments as well as the opportunity to see both current impact investment deals and future pipeline.
Toniic	International network of impact investors promoting investment in ‘entrepreneurs, enterprises and funds seeking to change the world for the better’.
Toniic 100% IMPACT Network	A fast growing group of Toniic members dedicated to building, sharing and promoting their 100% impact portfolio approach.
Mission Investors Exchange	A membership-based network of philanthropic organisations who are using program-related and mission-related investing as a strategy to accomplish their philanthropic goals. Based in the US and has some international foundations as members and affiliates.
Global Impact Investing Network Investors’ Council	Non-profit organisation dedicated to increasing the scale and effectiveness of impact investing. It focuses on building practice to overcome systemic barriers to impact investing and attract more capital to the field. The Investors’ Council is by invitation only and prospective members should have a minimum of USD 50 million in impact investment assets.



FINDING OPPORTUNITIES IN ASIA

The impact investment field within Asia is generally significantly less developed than both Europe and the United States. However, the Indian impact investing market is the most developed Asian market with many microfinance companies emerging in the early 2000s. In the last decade there has been a shift towards a broader “sector-agnostic” investment strategy in other areas such as healthcare, communications and technologies, as well as agriculture. Within India, there are also ongoing developments in self-regulation by key players in the social impact space such as the emerging Indian Impact Investing Council (IIIC).

The wider Asian impact investing market has also experienced an influx of government support and the establishment of tools that can be used to source and stimulate impact investment opportunities.

EXAMPLES OF SELECT ASIAN IMPACT INVESTMENT FUNDS

Credit Suisse Asian Impact Investments Fund

Credit Suisse Asian Impact Investment Fund aims to provide funds for small to medium sized enterprises in China and numerous other South-East Asian countries such as Thailand and Indonesia.

These countries have been selected due to the abundance of strong investment opportunities. The fund will target key sectors in Asia such as agriculture, where 81% of farmers need access to capital, as well as health, education, and clean water.

Lotus Impact

Lotus actively invests in private enterprises that help both social and environmental problems with sustainable solutions, such as employment and income generation. It employs a sophisticated investment process all the way from sourcing an investment to portfolio management.

Unitus Impact Livelihood Impact Fund

Unitus Impact is an impact investment firm with the mission of improving the livelihoods of the working poor in Asia’s fastest growing economies. Unitus Impact manages the Livelihood Impact Fund, a venture capital fund investing in early stage companies that link underserved populations to formal markets, engage the working poor as suppliers or distributors, and/or provide underserved consumers with products and services that improve their lives.

Impact Investment Exchange Asia Growth Fund

This fund manages impact investments in innovative, high-potential impact enterprises in South and Southeast Asia. The fund is a US\$50 million, for-profit, growth equity fund focusing on developing education, agriculture, energy, water, sanitation and healthcare sectors.

WAYS TO ACCESS PRODUCTS

Impact Investment Exchange Asia

Impact Investment Exchange Asia (IIX) is a Singapore-based organisation with a mission to provide Social Enterprises (SEs) in Asia greater access to investment capital, allowing them to more rapidly expand the impact of their activities. IIX now offers three investment platforms – Impact Accelerator™, Impact Partners™ and Impact Exchange™. Impact Accelerator™ provides seed-stage SEs with mentorship and private capital through a structured and customised process. Impact Partners™ connects accredited impact investors to selected growth-stage SEs who are looking to raise investment capital. Impact Exchange™, the world’s first social stock exchange operated by the Stock Exchange of Mauritius in collaboration with IIX, is a regulated stock exchange dedicated to listing and trading securities issued by mature SEs and other socially-driven organisations. To date, IIX has facilitated \$11 million of investment impacting more than 8.2 million people across Asia with \$19.5 million in social value created.

Asian Venture Philanthropy Network

The Asian Venture Philanthropy Network (AVPN) promotes venture philanthropy in both the broader philanthropic and social investment community. The purpose of AVPN is to provide an abundance of networking opportunities and learning services, in order to share best practice in the region. In order to support the capacity development of members in AVPN, they have established a capacity development model (CDM) that is relevant to the venture philanthropy practice, in particular the pre-engagement, capacity building, impact assessment, portfolio management and multi-sector collaboration stages.

Impact Base platform

Managed by the Global Impact Investment Network (GIIN), the Impact Base platform provides investors with the ability to search for and compare various impact investment funds, and provides fund managers with the opportunity to market their impact investment funds, in terms of both impact and financial return. It addresses fragmentation in the market and overcomes high search costs.

DIFFERENT TYPES OF INVESTMENTS: DIRECT VS INDIRECT

Depending on your impact investment strategy, you may have a preference to make direct or indirect investments. Utilising an intermediary often helps with structuring a deal. Even with an intermediary to structure a social enterprise deal, often an investor can still choose between a direct investment into the social enterprise or to indirectly invest into the social enterprise through a fund.

An intermediary, like Benefit Capital, can provide leads to direct investments, usually early stage social enterprises seeking start-up capital or later stage social enterprises seeking growth capital. Investing directly into these enterprises poses a problem of requiring an internal team to conduct due diligence on the opportunity. Combined with the early nature of many of these social enterprises, it can prove to be an onerous burden on small foundations.

In this situation, some people rely on the due diligence conducted by other people that you trust. An example of this is the investment in STREAT Enterprises to finance its acquisition of the Social Roasting Company,⁴⁰ where a group of impact investors, namely Donkey Wheel Foundation, Small Giants, the McKinnon Family Foundation and Fair Business, were able to rely on the due diligence completed by Paul Steele from the Donkey Wheel Foundation who acted as an intermediary in the transaction. Due diligence is discussed further later in this section.

“Borrowing off the credibility of co-investors and utilising intermediaries such as the SEDIF set of funds is a great way to simplify the highly technical and costly process of due diligence

– John McKinnon, McKinnon Family Foundation”

There may be other ways that direct investments can be de-risked. For example, the government guaranteed that the social impact bonds would pay a minimum return of 5% for the first three years. On the other hand, an indirect investment, like investing with an impact investing fund manager, can simplify the process, as the fund manager is responsible for the bulk of the due diligence on any direct investments. Hence, the investor's due diligence can be limited to examining the fund.

There are few impact investment funds managers who operate in Australia, but there are several examples on the following page.



FUND MANAGER	EXAMPLE FUNDS	DESCRIPTION
Foresters Group 	<ul style="list-style-type: none"> Community Finance Fund - Social Enterprise (CFFSE) Social Enterprise Finance Fund (SEFF) Early Stage Social Enterprise Fund (ESSEF) Arts Business Innovation Fund (ABIF) 	Foresters is a non-profit organisation that delivers community finance and social investment products; Foresters' subsidiary Social Investment Australia is the funds manager for Foresters' investment products
Social Ventures Australia (SVA) Impact Investing 	<ul style="list-style-type: none"> SVA Social Impact Fund Indigenous Social Enterprise Fund Social Impact Investment Trust 	SVA Impact Investing introduces new capital and innovative financial models to help solve entrenched problems. The Social Impact Fund provides both debt financing and equity to social enterprises.
Social Enterprise Finance Australia (SEFA) 	<ul style="list-style-type: none"> SEFA Loan Fund 	SEFA connects investor funding with social enterprises and mission led organisations. SEFA offers loan finance and capacity building support to enable community, environmental and indigenous enterprises to thrive and grow sustainably. It offers investors both social impacts and financial returns.
Impact Investment Group 	<ul style="list-style-type: none"> Impact Investment Group has trusts for each of their assets 	Impact Investment Group sources and develops investments that generate social and environmental value throughout the investment's life, as well as delivering excellent financial returns for investors
Indigenous Business Australia 	<ul style="list-style-type: none"> Indigenous Business Australia Scholarship fund 	Indigenous Business Australia is a progressive, commercially focused organisation that promotes and encourages self-management, and sufficiency, as well as economic independence for Aboriginal and Torres Strait Islander peoples.

POTENTIAL INTERMEDIARIES

INVESTMENT READINESS	SPECIALIST FINANCIAL	MAINSTREAM FINANCIAL
<ul style="list-style-type: none"> Social Traders Social Firms Australia Social Ventures Australia Social Enterprises Sydney Social innovation in Western Australia The Difference Incubator 	<ul style="list-style-type: none"> Foresters Group Social Enterprise Finance Australia Social Ventures Australia Social Finance Community Sector Banking Indigenous Business Australia Unitus Capital Indigenous Stock Exchange Fair Loans Foundation Many Rivers Microfinance Maleny Credit Union Donkey Wheel Australian Ethical Specialist advisory: Australian Impact Investments, Ethinvest, Benefit Capital Grace Mutual Australian Small Scale Offerings Board Blue River Group 	<ul style="list-style-type: none"> Bendigo JBWere Evans and Partners Colonial First State Investments AMP Capital Perpetual Investments Mercer Investments Bankmecu

CREATING YOUR OWN INVESTMENT OPPORTUNITIES

A number of seasoned impact investors are now starting to create their own impact investment opportunities. For example, if a trust or foundation has a longstanding relationship with a not-for-profit, they could suggest that a particular project may be more suitable for a loan than a grant.



We are currently considering a direct investment in a not-for-profit. We have a long standing grant relationship with this not-for-profit and it makes sense on many levels to consider investing with them as well.
- Cathy Truong, Trawalla Foundation



Geoff Harris is a successful businessman and entrepreneur who is interested in a blend of philanthropy and private enterprise. Harris was attracted to the social enterprise STREAT because of its aims to build and scale sustainable businesses that are also very effective in helping young disadvantaged people to re-establish their lives and become part of the community again.

Harris has supported STREAT with significant donations and is also an impact investor in STREAT Enterprises and its coffee roasting business. To help STREAT accelerate its growth, Harris purchased a \$2.5 million Collingwood property and leased it to STREAT at \$5 per year for the next 50 years. Harris retains ownership of the site and therefore any capital gain ultimately realised, but he has offered STREAT an innovative lease and security of tenure over the building.

Furthermore, Harris provides STREAT with business mentoring, encouraging STREAT to expand into corporate customers provided that the product offering is correct. Harris encourages other high net worth individuals to invest in social enterprises, especially in investments that are aligned with their strategic visions and values.

Outside investing in social enterprises and intermediaries, charitable trusts are encouraged to think laterally and explore how investments in traditional businesses can be used to generate social impact. There are some suggestions below on how charitable trusts can think about harnessing traditional for-profit investment for social impact:

- Growth capital for a business that has a product or a service that is already servicing a social need such as housing, health or education
- Ownership or control of a business and improving the accessibility of a product or service to the market through innovating the business model
- Working with an investment opportunity in order to revitalise the business's operations and/or culture to become more socially sustainable
- Working with an investment opportunity to improve an asset's operations, such as an office building, to become more environmentally sustainable
- Turn-around of unsuccessful businesses that serve a social purpose
- Undertaking place-based investing by focusing on a specific geographic locality and investing in-need areas in that area



ASSESSING INVESTMENT OPPORTUNITIES

Investment opportunities should be assessed against your impact investing strategy – see part 4 above. A clear decision-making and review structure is essential to effective execution of an impact investing strategy. Once people know your strategy is in place, you may be faced with a myriad of requests for investment. Good governance is required to be sure that the stated goals and policies of the foundation are used in practice.

When evaluating an impact investment, you want to consider:

1. What it is
2. Its financial return
3. Its risk profile
4. Its proposed impact

See part 4 above for guidance on articulating your portfolio parameters in relation to financial return, risk and impact.

INITIAL SCREENING OF IMPACT INVESTMENT OPPORTUNITIES

Depending on the size and structure of your charitable trust or foundation, the initial review of investment opportunities may be a function for the board or staff. The initial review should include, at a minimum, fit with mission, goals and strategy; potential for social return and preliminary assessment of potential for financial return. It should fit within the foundation's impact investment portfolio parameters.

When the potential investment clears the screening and reviewing process, the investment can proceed to a due diligence process, where a more in-depth research process is conducted on the investment to determine its suitability prior to deciding whether to invest.

DUE DILIGENCE: FINANCIAL PERFORMANCE AND IMPACT ASSESSMENT

Due diligence is the organisation's research and investigation of impact investment opportunities.

After an initial screening of impact investment opportunities, a foundation or their financial advisor should assess the opportunity in more detail before agreeing to make the investment. Due diligence usually entails a full review of financial statements or offering documents and other relevant organisational materials, as well as project-specific documentation, such as projections and business plans. Reviewing the documentation in detail, especially items such as fees and redemption conditions, is also very important to properly discharge trustee duties from a legal perspective.

I provide an investment paper for the Trustees that explains what the terms of the investment are, who the key parties are, what the returns are, what form the investment returns take...also the highlights as I perceive them or as the advisors perceive them. I don't provide a recommendation but I provide a good two or three page briefing paper.

- Cathy Truong, Trawalla Foundation

The quality of management is an important factor to consider, especially when supporting a direct impact investment. The team driving the enterprise will be key to ensuring that not only financial performance can be delivered but also the projected impact will be created.

“ I put a lot of trust into the people running an organisation that I invest in. There is uncertainty around one of my investments due to changes in the business plan, but I trust the people running it. I know them and they never fail!
– John McKinnon, McKinnon Family Foundation ”

In conducting due diligence on fund managers, it would normally be recommended to ensure that they have a strong track record in delivering results that match your organisation’s mission, values and objectives. This consideration may have less emphasis in the Australian context at this point in time, as there are few specialist fund managers in the impact investment space with substantial track record.

The financial analysis of an impact investment will usually be similar to that of a traditional investment, with the completion of a cash flow analysis and also the determined projected internal rate of return. A key factor is the return that the investor should expect in relation to the risk undertaken. Each investor will need to develop their own metrics for risk mitigation during the due diligence phase in order to determine whether the internal rate of return meets the risk-adjusted hurdle rate.

While standard due diligence checklists for traditional investments may be helpful in assisting the determination of whether an impact investment is suitable in relation to financial performance and risk, attention should also be paid to the qualitative factors in an investment. In the relatively undeveloped market of impact investments, it is helpful if investors remain flexible and are able to take into consideration different factors. For example, in the context of direct investments, it may be helpful to collaborate with other investors to conduct due diligence.

*“Due diligence is expensive and this is a challenge when you are a small foundation. You often need boots on the ground. As a small foundation it is hard to do this when you are far away unless you have partnerships and a network that is going to help share the load.”
– Lisa Kleissner, KL Felicitas Foundation*

Standard templates for performance review of impact investments can help institutionalise the evaluation process and facilitate external communication. An example of these is provided in the appendix of the field guide.

There also needs to be due diligence conducted on the proposed impact of the investment. For the impact to be meaningful, there should be alignment with your impact objectives. These objectives have hopefully been articulated as part of developing an impact investment strategy. Measurement of impact is discussed in detail in the next section. It is important to ensure that the investment is helping to achieve your organisation’s intended social or environmental impact purpose, but it is important to remember that there may be a trade-off with financial return.

“It’s all an intricate web – financial and impact performance are all part of the same conversation.” – Danny Almagor, Small Giants



In our case, having a few PAFs in the same investment provided comfort that there were several sensible eyes going over the investment. The other way, and how the US has evolved, is by having dedicated impact fund managers who do the due diligence.

– John McLeod, PAF



“In setting the investment scope and return expectations, the Foundation places reliance on economic analysis that is made on a deal-by-deal basis of the financial return potential and expected impact, and risk-adjusted return expectations are set accordingly.” – Luke Branagan, MLC Community Foundation

Impact due diligence can be conducted at a high level or in significant detail, depending on individual preferences. A possible template for impact due diligence is set out in the appendix of the field guide.

Most investments have a positive impact and a negative impact, and it may sometimes be unclear whether the positive impact outweighs the negative impact, so it is a net positive impact investment. It is also important to be aware that investments may have unintended impacts that sometimes may be conflicting. For example, there may be a conflict with an investment that has the potential of having a positive social impact whilst producing a negative environmental impact.

Whether or not a conflict arises will depend on the individual foundation's impact investing strategy and policy. For some foundations the sole impact focus may be social and there will be no environmental consideration in their investments. It is just important to be mindful that impacts are not mutually exclusive and unintended conflicts should be anticipated. Foundations should actively investigate and be aware of the potential for conflicts of impact that may not align with their impact investing strategy and determine whether the conflict can be resolved before a decision to invest in a particular project is made.

PROGRAM OVERSIGHT

Depending on the size of your foundation and its modus operandi, a standing impact investing committee of the board—perhaps an offshoot of the initial strategy development committee—can be a useful structure for selecting investments, reviewing performance, and suggesting course corrections where necessary.

This committee may:

- Submit potential investments for a vote by the board or have authority delegated by the board to make investment decisions.
- Set policies for approval by the board and set standards for managing the investment process.
- Monitor financial and social performance of investments.
- Make suggestions for developing strategic impact investing program areas (or collaborate with the foundation's grant making committee to align overall strategy).
- Coordinate with the foundation's investment and finance committees to ensure that impact investing is integrated into your foundation's overall budgeting process.



PART 6 | MONITORING PERFORMANCE AND MEASURING IMPACT



After making an impact investment, it then becomes important to continually monitor the performance of each investment. On a periodic basis, the steps taken to evaluate the investment should be performed on the existing investment to ensure that the financial and impact performance is tracked. You can actually assess the financial and impact performance of the investment against the benchmarks set out in the impact investment policy (discussed above on p 46-47).

IMPORTANCE OF MEASURING IMPACT

Impact measurement is one of the key differentiators of impact investing from traditional investing. It ensures that the investments being made actually have a positive social or environmental impact.

Different people place different levels of importance on measuring impact.

“Don’t worry too much about quantifying impact immediately. It is hard. However, keep in mind that any impact is better than none, so just get started!” – John McKinnon, McKinnon Family Foundation

“Impact measurements are really important and maybe we can look back at them later but right now we need to act.” – Danny Almagor, Small Giants



There are uncertainties that arise from the measuring of environmental and social impact. We see it as highly dependent upon peoples’ expectations. Hence, we are open to mixed models.

– Dave Allison, Akina Foundation



Measuring impact is challenging. It can be complex, time-consuming and costly. However, this does not mean it is not worthwhile. It is helpful to be **flexible** about impact measurement given its difficulty. It is often not possible to find all metrics relevant to social impact or would be extremely costly to do so in certain cases. Hence, the extent and complexity of the impact measurement should be **scaled to the circumstances of the investment**. It should be acknowledged that management must be pragmatic and not impose unnecessary measurement tools on businesses. Impact measurement should be a part of the indicators used by management teams to drive the overall performance of the business. Hence, each investor must also decide what information is most meaningful to them. There are a number of **tools that can assist** with the task of measuring impact and these are discussed below.

IMPACT MEASUREMENT METHODOLOGIES

Many impact measurement methodologies have arisen alongside the growth of the impact investing industry. However, these metrics and methodologies have generally been bespoke to suit each individual organisation’s missions and needs. This has resulted in difficulty comparing investments and has been an impediment for the maturing of the industry. Hence, this spurred the development of a standardised reporting standard for social and environmental impact of investments known as the Impact Reporting and Investment Standards (IRIS).

IRIS metrics aim to allow investors to compare the social and environmental activities outputs and outcomes across investments, just like how investors compare the net income or margins as standardised financial metrics.



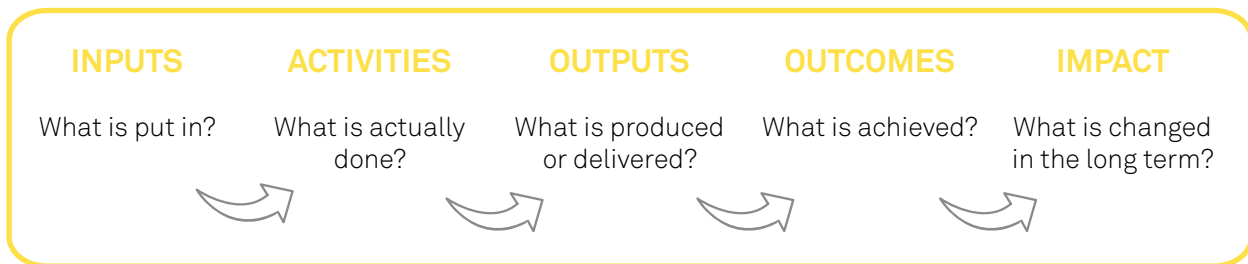
There's a qualitative measurement, there's a quantitative measurement and then there's the story. And you've got to look at all three.
– Danny Almagor, Small Giants



Despite the prominence of the IRIS metrics and their ability to be tailored for each investment, qualitative metrics should not be ignored and utilised where applicable. Qualitative metrics may also be very relevant where there is an intention to align investments with the organisation's mission. For example, KL Felicitas Foundation uses select qualitative metrics such as attraction of additional capital, business model development and innovation.

What do you measure?

It is possible to get quite sophisticated in identifying the correct indicators of impact, rather than just the outcomes. It is possible to develop a theory of change for each investment, as follows:



It is about understanding the impact that an investment creates, and to see where it comes from
– John McKinnon, McKinnon Family Foundation



It is often interesting to compare the impact of a particular investment over the course of the investment's life. Sometimes, it is intended that the investment improves its impact over the course of the holding by the impact investor. A foundation can develop an intentional strategy to drive further impact over the course of the investment's life. For example, the KL Felicitas foundation uses its grant funding in combination with its impact investments to drive further impact. It also leverages the time and expertise of the founders, Charly and Lisa Kleissner, to provide public support for their investments and so improve their impact over time.



Theory of Change

A theory of change is able to show an organisation's path from needs to activities to outcome and finally reaching their desired impact.

When creating a theory of change, focus on the following factors

1. Identifying a realistic and definite goal – think about what the ultimate aim of this pursuit is
2. Work backwards from the goal to work out the intermediate outcomes – think about what needs to happen in order to achieve the goal
3. Establish links between outcomes, and their order, by working out causes and effects – think about whether the links actually lead to one another, and why you believe that this is the case
4. Work out which activities will lead to which outcomes
5. Identify what else is needed for the intervention to work – think about what could potentially lead to the inability to achieve this goal

Who should conduct the measurement?

There are several models as to how impact measurement can be conducted, and it can vary for different investments:

1. Quantitative measurement by social enterprise

The social enterprise itself is generally best positioned to report on its own social impact, just as it provides financial reports to investors. It can use the IRIS metrics to provide social impact measurements. Many impact investments work in this way, such as with the KL Felicitas Foundation's investments in Asia, where each social enterprise provided impact measurements to the foundation and the foundation then audited the metrics when necessary. The necessity to audit the report may depend on the trustworthiness of the entrepreneur, although it is often helpful to have an objective assessment.

2. Quantitative measurement by intermediary

Where there is an intermediary, such as a fund manager, they will often conduct impact assessments which they consider appropriate to the investment and report to the investors. An example of this approach would be Social Ventures Australia Social Impact Fund or Impact Investment Group, both of which report to their investors annually on the social and environmental impact of their various investments.

3. Qualitative measurement by investor

Measuring quantitative impact may sometimes be too costly, especially if you are focused on financial-first impact investments. In this case, subjectively knowing that the investment provides some form of social and environmental impact can be sufficient to proceed with the investment.



The project or investment should be conducting the measurement and evaluation, not the investors. This is because they are in a better place to know what social measures to track and the metrics to use.

– John McLeod, PAF



An example of how KL Felicitas monitors their investments:

“Beartooth Capital is investing in distressed farmland in the US. They put conservation easements on the land, so they conserve in perpetuity a part of the land or the majority of the land and then they do some limited development, whether it be a ranch or some small commercial or private usage that would be able to attract the capital to buy them out. So on the financial side it is special real estate, so real estate is the sub-asset class which you would use for the benchmark on the financial side. In that particular instance, the social impact is about number of acres protected, number of miles of stream restored, number of jobs created in the community. So those are the metrics we use on the non-financial side to measure the impact.”

– Charly Kleissner, KL Felicitas Foundation

IMPACT MEASUREMENT TOOLS

Just as IRIS has reformed and standardised the metrics that can be used to measure social and environmental impact, third party impact evaluations are now helping to further standardise and mature the industry. These tools are designed to simplify the process of accessing and assessing impact investments for potential impact investors. One prominent example is the Global Impact Investing Rating System (GIIRS), which is intended to be analogous to Morningstar investment ratings,⁴² providing an evaluation of the social and environmental impact of enterprises and funds. GIIRS looks at the areas of governance, employees, community, environment, suppliers and consumers to output a rating on a scale between 0 and 200, which is updated and verified annually to ensure that the rating remains up to date and reflects any changes in the enterprise or fund.⁴³

Given GIIRS is a third party evaluator, typically GIIRS will rate investments which are more mature, as the process which must be undertaken to be assessed by GIIRS requires a 3 year commitment and many social enterprises do not see the value in doing so at an early stage. The exposure of GIIRS within the Australian context is also very limited, and while it may proliferate over the medium-term, it is likely that assessing the impact of Australian investments will require the use of IRIS or an alternative tailored approach.

RESULTS BASED ACCOUNTABILITY⁴⁴

Results Based Accountability (RBA) is a planning, monitoring, evaluation and continuous improvement framework that focuses on outcomes. It utilises a data-driven, decision-making process to help both communities and organisations take actions and solve problems. In terms of community, the RBA is able to help identify the progress a community is making towards achieving community well-being. However, in organisations, RBA can help identify the role and impact of the organisation in the wider community by evaluating the beneficiaries of the goods or services that the organisation provides.



SROI

Social Return on Investment is a methodology that aims to quantify social impact by attributing a monetary value to particular outcomes. The SROI Network and the SROI Toolkit are two customisable assessment and management systems utilising SROI principles.





B CORP⁴⁵

B Corp is a certification standard which takes into account an organisation's social and environmental performance, accountability and transparency. It is managed by the non-profit B Lab, which launched its Australian arm in 2014. The certification by B Lab ensures that the enterprise meets a minimum set of standards with regard to the impact that it generates, and 10% of B Corps are audited by B Lab each year to maintain the integrity of the certification. Some impact investors like Small Giants use the B Corp certification as an impact assessment tool and insist that all their investee companies become B Corporations.

AERIS⁴⁶



Aeris is a portfolio management and benchmarking tool that provides standardised data on financial and impact performance of community development financial institutions (CDFIs). It assists in allowing the evaluation of opportunities to meet the impact goals and risk parameters. The tool is currently limited at the moment to CDFIs within the US, however it serves a wide range of causes in terms of promoting financing for economic equality, environmental sustainability, food access, health care, education, affordable housing, amongst a range of other causes. PULSE is a portfolio management tool run through

PULSE⁴⁷



Application Experts (App-X) which allows tracking of benchmark financial, operational, environmental and social data to capture different measures of impact. The tool utilises the IRIS framework as part of the metrics which are measured, alongside the ability to develop custom metrics for projects and investments.

MANAGING RISK

The risks of each investment should continue to be regularly assessed and mitigated where possible. See pages 51 and 52 above for the discussion of managing risk.



APPENDICES

APPENDIX 1 – AUSTRALIAN AND INTERNATIONAL CASE STUDIES

A number of practical insights are included throughout this guide. This appendix contains brief descriptions of the organisations that were represented by the practitioners interviewed.

THE MCKINNON FAMILY FOUNDATION

The McKinnon Foundation is the family foundation of John McKinnon and his wife Sue. The Foundation is a private ancillary fund with a mission to support the environment, poverty alleviation and social enterprise development. Coming from a funds management background, John began actively managing the Foundation in 2012 and is keen to maximise use of the Foundation's assets, which means investing the corpus as much as possible in line with their own values. Currently, the Foundation has around 10% of its portfolio in impact investments, and has invested in a number of opportunities domestically in Australia and overseas. John and Sue have a goal to reach 100% of their portfolio in impact investments.

It has invested in all three SEDIF set of funds, numerous domestic investments as well as four international opportunities. John emphasised the benefit of making use of the due diligence carried out by the funds. To source these investments, the Foundation has largely relied upon John's personal networks and word of mouth. To budding impact investors, John gives the advice that you should find an impact investor and get the lay of the land! This is something John did not have when he began impact investing, as the market was so young. The McKinnon Foundation's investments include:

1. **Lismore Soup Kitchen** – \$300,000 secured property loan to a social enterprise that provides meals and accommodation to marginalized individuals;
2. **REBBL** – \$50,000 equity and convertible debt investment into a social enterprise operating in Peru, India and Thailand;
3. **The Foresters Early Stage Social Enterprise Finance Fund** – provides business development loans to early stage social enterprises;
4. **The Unitus Impact Livelihood Impact Fund** (see pg 57)
5. A property backed loan to the **Queensland Womens Legal Service**, through a Foresters sub fund.
6. **The Chepstowe Wind Farm via the Impact Investment Group Chepstowe Trust**. This is a 3 turbine wind farm in regional Victoria providing clean renewable energy.

KL FELICITAS FOUNDATION

The KL Felicitas Foundation (www.klfelicitasfoundation.org) is a California-based private family foundation that was established by the Kleissner family in 2000 with the mission of supporting social entrepreneurs and enterprises worldwide to grow sustainably and to deploy their capital to create positive change and address major world problems.⁴⁸ One important objective of the Foundation is to inspire others to leverage their assets for creating positive impact. Transparency, accountability, and open source sharing of information are therefore core guiding principles and values.⁴⁹

The KL Felicitas founders, Charly and Lisa Kleissner, first became interested in sustainability, mission and social investments as a way to break down the "value/ethic firewall" between their personal and business lives.⁵⁰ KL Felicitas initially used negative screening as its impact investing strategy, but soon realized that the impact was indirect, unleveraged and unaligned as well as nearly impossible to measure.

At the same time, they made the strategic decision to hire a team of advisors rather than rely on any one consultant or firm to provide full services, which culminated in the creation of a multi-disciplinary team.⁵¹

Impact investing is a logical extension of the Kleissners' core beliefs. It enables the foundation to use a wide range of investment vehicles to support social enterprises, including grants, social loans, loan guarantees and private equity.⁵² KL Felicitas currently has invested 98% of its \$10 million corpus in impact investments that align with their mission but have set their goal at moving to 100% of their portfolio in impact investments.

THE TRAWALLA FOUNDATION

The Trawalla Foundation was established in 2004 by the Schwartz family as a vehicle for its life-long philanthropic activities. The Trawalla Foundation grant program reflects the active, thoughtful and progressive attitudes of the trustees. In particular the foundation focuses upon supporting the arts, innovation and scholarship. Within these areas, it specifically pursues programs that promote women into leadership positions as well as sustainability in both the environment and civil society.

Its impact investing activities have centred around several key structured and well-known investments, including Goodstart Early Learning, the SVA Social Impact Fund and the Benevolent Society Social Benefit Bond.

SMALL GIANTS

Small Giants was founded in 2007 to create, support, nurture and empower businesses that are shifting society to a more socially equitable and environmentally sustainable world. Small Giants acts as a catalyst for change, using business as a meaningful tool to create the world in which we want to live. From deep partnerships with start-up social enterprises, to investments in large-scale social and environmental projects, to radically sustainable property development, the Small Giants portfolio reflects a deeply passionate and innovative ethos. Small Giants was established by Berry Liberman and Danny Almagor.

Small Giant's investments include:

1. **The Impact Investment Group**, a leading Australian impact investment funds manager. IIG sources and develops investments that generate social and environmental value throughout the investment's life, as well as delivering excellent financial returns for investors.
2. **TOM** was born in Melbourne, Australia; the only Australian Certified Organic tampon brand, prioritising your health & the environment for that certain 'Time Of Month.'
3. **STREAT** is a social enterprise providing homeless youth with a supported pathway to long-term careers in the hospitality industry.
4. **The Commons** is Australia's most sustainable apartment building, showcasing some incredible renewable technology and creating an urban community like no other.
5. **Unitus Impact Livelihood Impact Fund** focuses on improving the livelihoods of the working poor by supporting growth of scalable, financially attractive ventures.

MLC COMMUNITY FOUNDATION

MLC is the wealth management division of the National Australia Bank (NAB) and provides investment, superannuation, insurance and financial advice to corporate, institutional and retail customers.⁵³ MLC Community Foundation was established in 2008 as a Private Charitable Trust, and is dedicated to improving the mental health and wellbeing of Australians. The Foundation actively supports the growth of vibrant and sustainable communities and has granted more than \$7.8 million to not-for-profit organisations to support their critical work in mental health. The MLC Community Foundation has established its strategy and approach for participating in the impact investment market, and continues to look for its first suitable

impact investment opportunity aligned to its mission. (Since interviewed, Luke Branagan has now joined the JBWere Philanthropic Services Team.)

JOHN MCLEOD

John McLeod joined JBWere's Philanthropic Services team in 2001, after 16 years in the equity market. In 2004, John established a private ancillary fund (PAF), and also began to consult to private philanthropy sector on a broader level.⁵⁴ John's PAF investment policy and strategy includes asset allocation ranges and ethical considerations. He has a broad investment approach, hence his investments do not follow specific sectors or geographic areas.

THE ĀKINA FOUNDATION

The Ākina Foundation was a new name adopted in 2014 for the foundation that was previously known as Hikurangi. Ākina is expanding its mission and stepping up its activity across New Zealand, building on the energy of everyone who has been involved with the Hikurangi Foundation since 2008 when the Todd and Tindall Foundations established the Hikurangi Foundation to support practical action on climate change and the environment.⁵⁵ Ākina have funded and supported a wide range of grassroots and community-led innovation across New Zealand.⁵⁶

Ākina's mission is to grow the emerging New Zealand social enterprise sector by:⁵⁷

- Activating talent, raising awareness and building capability for social enterprise
- Supporting high-potential social enterprises to deliver scalable solutions to pressing social and environmental challenges
- Facilitating new market and investment opportunities for social enterprise.

Ākina's vision is for a sustainable, prosperous and inclusive world. It believes social entrepreneurs and social enterprise represent a powerful opportunity to build a new economy that regenerates the environment and creates social foundations for people to thrive.

The people who work for the Ākina Foundation are in service to social entrepreneurs who commit themselves to creating benefit for others. Ākina seeks to support them with excellence, humility, flexibility and courage.

APPENDIX 2 – IMPACT INVESTMENT EVALUATOR⁵⁸

Investment name:

Investment amount (\$):

Investment date:

Asset class:

Region of impact:

Investment due diligence by: _____ Signature: _____ Date: _____

Impact due diligence by: _____ Signature: _____ Date: _____

Summary description of investment:

Main contacts:

Supporting documents:

Impact due diligence update:

Financial due diligence update:

PROGRAM/MISSION/SUSTAINABILITY DUE DILIGENCE

ALIGNMENT WITH THE FOUNDATION		SCORE
<p>1a. How does this investment align with the impact objectives of the foundation?</p> <p>b. In what area(s) does the foundation believe this investment will contribute the greatest degree of impact?</p>	<p>a.</p> <p>b. <input type="checkbox"/> Program Impact <input type="checkbox"/> Mission Impact <input type="checkbox"/> Sustainability Impact</p> <p>Notes:</p>	
<p>2a. Are there any elements of this investment that are contrary to any value(s) of the foundation?</p> <p>b. If so, how is this being addressed?</p>	<p>a. <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>Notes:</p> <p>b.</p>	
RELATIONSHIP & REPUTATION		
<p>3a. How well does the organisation know the investment and/or strategy?</p> <p>b. What is the nature and duration of this relationship?</p> <p>c. Has the foundation made a site visit/met the investment principals?</p>	<p>a.</p> <p>b.</p> <p>c. <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>Notes:</p>	
<p>4a. Have other organisations recognised this as an impact investment?</p> <p>b. Do other respected organisations have a relationship with or experience with this investment?</p>	<p>a. <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>Notes:</p> <p>b. <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>Notes:</p>	

<p>5a. How integral to the success of the investment is:</p> <p><input type="checkbox"/> Program Impact <input type="checkbox"/> Mission Impact <input type="checkbox"/> Sustainability</p> <p>b. What is the form and level of personal commitment by the investment principals and/or founders to the impact described above?</p> <p>c. How much personal financial capital have the investment principals and/or founders committed to the investment?</p>	<p>a.</p> <p>b.</p> <p>c.</p>	
IMPACT MONITORING & REPORTING		
<p>6a. What approach will be used to evaluate and measure the impact of the investment? Are there specific metrics for reporting?</p> <p>b. What is the proposed nature and scale of the impact, e.g. in 1yr, 3yrs, long-term?</p>	<p>a.</p> <p>b.</p>	
<p>7. Will the Investment Manager provide impact-related reporting?</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>Notes:</p>	
<p>8. Does the investment scale, accelerate, support or re-enforce other Impact Investments in the investment or grant portfolios?</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>Notes:</p>	
<p>Additional comments or observations:</p>		

INVESTMENT DUE DILIGENCE

INVESTMENT STRUCTURE & PORTFOLIO IMPLICATIONS	SCORE											
<p>9. Investment due diligence process</p>	<p><input type="checkbox"/> Impact first due diligence process</p> <p><input type="checkbox"/> Financial first due diligence process</p> <p><input type="checkbox"/> Other (describe any exceptions or modifications to the due diligence process).</p> <p>Notes:</p>											
<p>10a. What is the structure of the investment under consideration?</p> <p>b. Is the investment structure ideally suited to achieve both the appropriate risk adjusted rate of return while promoting the foundation's impact objectives?</p>	<p>a.</p> <p>b. <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>Notes:</p>											
<p>11. Asset Class</p>	<table border="0"> <tr> <td><input type="checkbox"/> Cash and Equivalents</td> <td><input type="checkbox"/> Venture Capital</td> </tr> <tr> <td><input type="checkbox"/> Fixed Income</td> <td><input type="checkbox"/> Private Equity</td> </tr> <tr> <td><input type="checkbox"/> Public Equity</td> <td><input type="checkbox"/> Real Estate</td> </tr> <tr> <td><input type="checkbox"/> Hedge Funds</td> <td><input type="checkbox"/> Real Assets</td> </tr> <tr> <td><input type="checkbox"/> Notes:</td> <td></td> </tr> </table>	<input type="checkbox"/> Cash and Equivalents	<input type="checkbox"/> Venture Capital	<input type="checkbox"/> Fixed Income	<input type="checkbox"/> Private Equity	<input type="checkbox"/> Public Equity	<input type="checkbox"/> Real Estate	<input type="checkbox"/> Hedge Funds	<input type="checkbox"/> Real Assets	<input type="checkbox"/> Notes:		
<input type="checkbox"/> Cash and Equivalents	<input type="checkbox"/> Venture Capital											
<input type="checkbox"/> Fixed Income	<input type="checkbox"/> Private Equity											
<input type="checkbox"/> Public Equity	<input type="checkbox"/> Real Estate											
<input type="checkbox"/> Hedge Funds	<input type="checkbox"/> Real Assets											
<input type="checkbox"/> Notes:												
<p>12. Will directors of the foundation play an active role in the investment?</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>Notes: If yes, conflicts of interest must be properly managed</p>											

INVESTMENT MONITORING & REPORTING			SCORE
<p>13a. What is the financial benchmark that will be used to evaluate this investment?</p> <p>b. Over what period(s) of time will the investment performance be measured?</p>	<p>15a.</p> <p><input type="checkbox"/> Market indices</p> <p>Specify:</p> <p><input type="checkbox"/> Absolute Return</p> <p>Specify:</p> <p><input type="checkbox"/> Peer Group Comparison</p> <p>Specify:</p> <p>Notes:</p>	<p>15b.</p> <p><input type="checkbox"/> < 1 year</p> <p><input type="checkbox"/> 3-5 years</p> <p><input type="checkbox"/> 5-10 years</p> <p><input type="checkbox"/> 10-20 years</p> <p><input type="checkbox"/> > 20 years</p> <p>Notes:</p>	
<p>Additional comments or observations:</p>			

IMPACT REPORTING AND INVESTMENT STANDARDS (IRIS)

This investment will track the following core IRIS impact indicators:	Data at time of investment	Future impact data (specify date)
<p>Number of clients (P17094) – <i>number of individual consumers served by the organisation</i></p> <p>Jobs Created in Financed Enterprise (P13687) – <i>number of new FTE jobs at financed enterprise(s)</i></p> <p>Direct Investment (FP4359) – <i>number of debt and equity investments on balance sheet</i></p> <p>New Investment Capital (FP8293) – <i>value of cash flows from both loans and investments</i></p> <p>Contributed Revenue (FP3021) – <i>all contributed revenue, including operating grants and in-kind donations</i></p>		

This investment will track the following core IRIS impact indicators:	Data at time of investment	Future impact data (specify date)
<p>Earned Revenue (FP5958) – <i>revenue resulting from all business activities</i></p> <p>Net Income (FP1301) – <i>net income from all business activities, including all contributed revenue</i></p>		
Reporting Schedule: <input type="checkbox"/> Quarterly <input type="checkbox"/> Bi-Annual <input type="checkbox"/> Annual <input type="checkbox"/> Other		
Notes:		

SUPPORTING IRIS INDICATORS

This investment will track the following supporting IRIS impact indicators:	Data at time of investment	Future impact data (specify date)
<p>[Insert relevant IRIS indicators. Some examples are offered below]</p> <p>Number of clients provided new access to energy, healthcare, or water (PI2822) – number clients, individuals, or households who were served by the organisation and provided access to products or services that they were previously unable to access</p> <p><input type="checkbox"/> New access to energy</p> <p><input type="checkbox"/> New access to healthcare</p> <p><input type="checkbox"/> New access to water</p>		
<p>Energy Produced (PI8706) – <i>total amount of energy produced during the reporting period (MWh)</i></p> <p>Potable Water Produced (PI8043) – <i>amount of potable water produced during the reporting period (L)</i></p> <p>Land Reforested (PI4907) – <i>hectares of land reforested during the reporting period</i></p>		

This investment will track the following core IRIS impact indicators:	Data at time of investment	Future impact data (specify date)
Land Preserved (PI2012) – <i>hectares of land designated as nature reserve</i> Sustainable Cultivated Land (OI2605) – <i>hectares of land under sustainable cultivation</i>		
Reporting Schedule: <input type="checkbox"/> Quarterly <input type="checkbox"/> Bi-Annual <input type="checkbox"/> Annual <input type="checkbox"/> Other		
Notes:		

FOUNDATION QUALITATIVE INDICATORS

The following qualitative indicators pertain to this investment. Add detail for each, where needed.

Notes:

APPENDIX 3 – IMPACT INVESTMENT BRIEF⁵⁹

Project / Social Enterprise / Fund Name

High level description of investment opportunity, including investment source

1. Investment Summary

SUMMARY	DESCRIPTION
Borrower	Name, legal status
Investment Type	Debt / Equity, specifics
Investment Size	<ul style="list-style-type: none">Total funding required, including other sources of funding.Minimum / Average investment expected from the foundation
Term	Expected investment period
Purpose	Reason for raising capital
Expected Financial Return	Income / Capital Growth projection summary
Expected Social Return	Statement of impact areas / overall assessment (H, M, L)
Closing Date	Key dates relating to deal
Investors	List of other known investors
Fees	List of management, performance, exit fees, etc.
Legal Structure(s)	As needed
Key Personnel	Key executives and intermediaries
Rationale for Investment	<ul style="list-style-type: none">Rationale as to why entity is seeking your foundation as investor.Rationale as to why this is a fit with your foundation's impact investment approach.
Further Information	As needed

2. Financial Analysis

3. Social Impact Analysis

4. Risk Identification and Assessment

Attachments (if applicable):

- Information Memorandum / Prospectus (if available)
- Term Sheet
- Financial statement history and forecasts
- Due Diligence summary

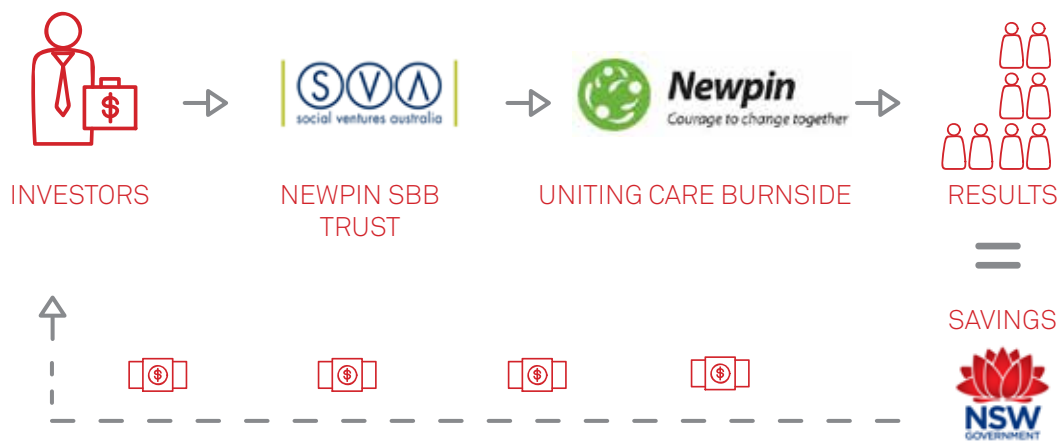
APPENDIX 4 – FIRST AUSTRALIAN SOCIAL BENEFIT BOND

NEWPIN BOND

The Newpin Social Benefit Bond (SBB) was the first social impact bond in Australia. The Newpin program is a centre-based therapeutic service that seeks to restore children from out-of-home care to safe families.

The contractual relationship between the three parties to the transaction; NSW Government, UnitingCare Burnside and the private investors is underpinned by two main performance based contracts. There is an implementation deed between Government and UnitingCare Burnside and a loan deed between the Newpin SBB Trust and UnitingCare Burnside. The investors are issued loan notes from the Newpin SBB Trust. Social Ventures Australia is the security trustee and the manager of the Newpin SBB Trust. The structure allows all parties to share in the risk and reward from performance.

The performance of the contracts is determined by the restoration of children from out-of-home-care to safe families. The social performance drives a financial return which is paid by Government to the service provider from the projected savings. Investors receive a minimum 5% return during the first year of the SBB and are expected to receive a return between 5-12% during the 7.25 year life of the SBB. The return is capped at 15%. The target restoration rate is 65% and a termination trigger is set at 45%. 100% of principal is protected where the restoration rate is over 55%. The diagram below depicts the flow of funds.⁶⁰



APPENDIX 5 – WORKING WITHIN YOUR TRUST’S LEGAL STRUCTURE

This section presents the main questions that trustees may want to consider about their trust’s current legal structure. Furthermore, it provides useful considerations for individuals potentially setting up a new charitable trust, and the best way to draft a trust deed to allow impact investments to be made.

The considerations are broken down into a number of steps across the following areas:

- Step 1: Examining the trust deed;
- Step 2: Navigating trustees’ legal duties;
- Step 3: Categorising a trust entity as a sophisticated investor;
- Step 4: Constructing the investment policy; and
- Step 5: Consider the role of fund managers.

STEP 1: EXAMINING THE TRUST DEED

To determine if a trust can undertake impact investing, trustees should firstly examine the trust deed for any directions or restrictions on a trustees’ investment power. The trust deed is the legal document that captures the intentions of the individual who started the trust and therefore, should always be observed.

Most trust deeds set out the power of investment very broadly. The trust deed generally would not have a positive power for impact investing and similarly, would not set out restrictions that limit impact investing. Some deeds may require capital to be held in perpetuity with no provision to distribute. For Trustees with such Deeds caution and legal advice is recommended.

It is a positive sign if there are no restrictions in the trust deed, particularly if there is power to meet objectives with capital as well as income distributions. Trustees can engage in impact investing if they stay focused on proposals that offer an appropriate rate of return for the risk involved. It is not necessary to modify a trust deed that does not restrict impact investing to explicitly permit it.

After examining the trust deed, if a trustee finds that it does restrict impact investing, a trustee may want to consider making changes to the trust deed. If there is explicit power to amend the Deed contained within the Deed this can be relatively straightforward. If a trustee wishes to modify the trust deed, it is suggested that the trustee seek legal advice from a practicing lawyer qualified to give advice on trust law.

For someone thinking about setting up a new charitable trust, you could consider specifying in the trust deed that the trustee can or should have regard to certain criteria, including social impact, when making an investment decision.

STEP 2: NAVIGATING TRUSTEES’ LEGAL DUTIES

Many trustees of charitable trusts and foundations are concerned with how to navigate their legal duties. Trustees are often wary about making impact investments because it may involve a departure from the traditional understanding that trustees must invest in order to maximise the financial return of the trust.

Trustees’ duty to administer the trust

Under general law, trustees do not have a duty to invest but rather trustees have a legal duty to administer the trust in accordance with the trust deed.⁶¹ Therefore, a trustee must always refer to the trust deed to see what the investment requirements are.

If there are no specific directions or restrictions, but rather a general power to invest, trustees are likely to be required to earn sufficient income to meet the purpose of the trust, which is to make grants in order to further a designated purpose. From a practical perspective, this means that trustees must make investments that either earn income or make capital gains, in order to provide the income that enables them to make distributions for a charitable purpose.⁶² For further information on this point, please refer to the Philanthropy Australia Trustee Handbook.⁶³

Trustees should additionally note that the minimum distribution requirements for PAFs and PuAFs set out in the respective guidelines are not duties.⁶⁴ Instead, the requirement is a regulatory hurdle for a charitable trust to maintain its tax status. In other words, trustees will not be held legally liable if they fail the minimum distribution requirement,⁶⁵ although it is highly undesirable for a trust to lose its tax-deductible status and it could potentially be regarded as a breach of trust if it could be shown to have flowed from a lack of care or some other deficiency on the part of the trustee.

“The Foundation is a private charitable trust. The Foundation has no required minimum distribution, unlike PAFs and subsequently the Foundation has not considered any discounts to the return received that can be attributable to the delivery of a social benefit.

– Luke Branagan, MLC Community Foundation”

Making impact investments in light of the legal duties

Finance-first impact investments, where there is a risk-adjusted financial return, do not give rise to any difficulty with respect to legal duties.

Not even every investment that makes a below-market return will create a potential liability. A court recognises modern investment strategy and looks at an individual investment's place in an entire portfolio. Individual investments must still make a risk adjusted return.⁶⁶ Therefore, if an impact investment were made, with appropriate risk-adjusted return, even with a very low return, a trustee will not be legally liable. Similarly, trustees can make a patient capital investment, as long as the return a few years down the track is justified by the risk. A trustee could supplement the lack of income from a patient capital investment with investments with a higher income yield.

Clear trustee duties

Trustees are subject to a duty to avoid conflicts of interest and duty.⁶⁷ For example, a clear conflict of interest arises when a Foundation is considering making an investment in a social business where one trustee also sits on the Board of Directors of that social business. That individual needs to declare that conflict and recuse him/herself and not participate in that decision. Trustees need to understand that they are no longer the legal owners of the capital in the trust for personal ends and therefore cannot participate in decisions in which they may have a conflict of interest.

Furthermore, trustees owe a duty of care to the trust.⁶⁸ Trustees ought to conduct business of the trust in the same manner that an ordinary prudent person in business would conduct his/her own business. Therefore, trustees should always follow due process in making investment decisions, either from the trust deed or the investment policy.

Trustees also have a duty to act for proper purpose.⁶⁹ For further information on this and other duties, please refer to M Scott Donald, Jarrod Ormiston and Kylie Charlton.⁷⁰

It is important for all trustees to be mindful of their legal duties. If a trustee feels unclear or uncertain about any of their duties, they should seek legal advice from a qualified trust lawyer before executing an investment decision.

STEP 3: CONSIDER THE CLASSIFICATION OF A TRUST AS A SOPHISTICATED INVESTOR

Trustees should consider whether the trust is classified as a sophisticated investor under the Corporations Act 2001 (Cth). A trust is a sophisticated investor if the trust is controlled by a person who meets the requirements of being a sophisticated investor.⁷¹ An individual is a sophisticated investor if they have net assets of at least \$2.5 million or income exceeding \$250,000 per annum over the last two years.⁷²

This consideration is presently very important because many impact investing funds or social benefit bond offerings can only accept investment from sophisticated investors.

Currently, there is some ambiguity or at least differences of opinion in interpreting the legislative provisions relating to whether or not some charitable trustees meet the requirement of a sophisticated investor. In the context of a PAF, it is ambiguous what 'control' by a sophisticated investor means, especially since there are usually a minimum of three trustees and the founder (who is often the sophisticated investor) may only be one of the trustees. This causes some PAFs to miss out on impact investment offerings, simply because a lack of clarity, even if they were legally eligible.

STEP 4: THE CONTENT OF AN INVESTMENT POLICY

There is a legal requirement that all PAFs and PuAFs formulate and adhere to an investment policy.⁷³ In the case of a typical charitable trust, there is no legal requirement for an investment policy but there is a requirement for prudent investing and annual reviews (which is best done by having an investment policy).

Some key questions that a trustee may want to consider are:

- Does the investment policy explicitly make reference to impact investment strategies and measuring the impact? Explicitly referencing impact criteria may direct trustees to actively consider investments that create social impact.
- Does the investment policy prohibit investment in certain classes of assets, which leads to reducing a portfolio's overall impact? For example, investments in bonds may create the most positive social or environmental impact but a portfolio may significantly focus on public equities for their tax benefits (as most trusts and foundations can claim the franking credits).
- Is there a strong focus on financial return that may place an onerous financial benchmark for a trust to meet? This may reduce a trustee's confidence in investing in an investment with a higher social impact but perhaps a higher risk of not outperforming the market.

Please see Part 4 of this guide for a more detailed guide to constructing an investment policy.

STEP 5: THE ROLE OF FUND MANAGERS

Trustees should consider the role their current fund manager or an alternative potential fund manager could play in facilitating impact investing. Some key questions are:

- Does a particular fund manager have the internal capabilities to facilitate impact investment?
- Can you direct your fund manager to invest in accordance with a modified investment policy that specifies impact criteria?

The relationship between trustees and fund managers is usually contractual, where a fund manager is appointed for a period of time, under certain terms and conditions. Depending on what has been agreed upon in the contract, it may be very easy or very challenging to direct a fund manager to focus on impact investing. Some key considerations for trustees in relation to the relationship of a trust with its fund managers are:

- Is there a formal contract in place that sets out the scope of a trust and fund manager's relationship?
- Does a contract allow for renegotiation or termination? Usually, a contract should account for considerations such as a changing investment policy or an annual review of the fund manager.
- What is the contractual risk? Will renegotiating a contract mean that a trustee is susceptible to price changes, thus reducing returns on investment?



RESOURCES

This resources list is adopted from Impact Investing Australia, *Impacting Investing: A primer for Family Offices*, and *Guide to Impact Investing for Family Offices and High Net Worth Individuals*.

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Impact Investments: Perspectives for Australian charitable trusts and foundations (2014)

K.Charlton, S.Donald, J.Ormiston & R.Seymour

Impact Investments: The invisible heart of markets (2014)

Social Impact Taskforce

IMPACT INVESTOR RESOURCES

WEB-PLATFORMS

Artha

www.arthaplatform.com

Gate Impact

www.gateimpact.com

ImpactAssets

www.impactassets.org

IMPACTBASE

www.impactbase.org

IMPACT PARTNERS

impactpartners.asiaiix.com

MISSION MARKETS
missionmarkets.com

ADVISERS

AlphaMundi
www.alphamundi.ch/index.php/en/

Arabella Advisors
www.arabellaadvisors.com/use-your-investments/

Australian Impact Investments
www.australianimpactinvestments.com.au

Blue River Group
www.blueriver.com.au

Calvert
www.calvertfoundation.org

Imprint Capital
www.imprintcap.com

onValues
www.onvalues.ch/en/

Renewal Partners
www.renewalpartners.com

Rockfeller Philanthropy Advisors
www.rockpa.org/impactinvesting

RSF Social Finance
www.rsfsocialfinance.org

Sonen Capital
www.sonencapital.com

Veris Wealth Partners
www.veriswp.com

Bank Degroof
www.degroof.com/sites/degroof/en-US/Pages/default.aspx

BNP Paribas
[www.bnpparibas.com.au/en/Impact Investing Networks](http://www.bnpparibas.com.au/en/Impact%20Investing%20Networks)

INVESTOR FOCUSED NETWORKS, GROUPS/ CLUBS

The Aspen Network of Development Entrepreneurs
www.aspeninstitute.org/policy-work/aspen-network-development-entrepreneurs

Confluence Philanthropy, USA
www.confluencephilanthropy.org

European Venture Philanthropy Association
www.evpa.eu.com

European Impact Investing Luxemburg (EILL)
www.impact-investing.eu

Global Impact Investment Network
www.thegiin.org/cgi-bin/iowa/home/index.html

More for Mission Investing
www.missioninvestors.org

Nexus Global Youth Summit
www.nexusyouthsummit.org

Go Beyond
go-beyond.biz

Investors' Circle
www.investorscircle.net

PYMWYMIC
www.pymwymic.com

Skoll Foundation
www.skollfoundation.org

The South African Network for Impact Investing, South Africa
www.saiin.co.za

TONIIC
www.toniic.com

Cleantech Group
www.cleantech.com

CGAP
www.cgap.org

INVESTEE FOCUSED NETWORKS

Ashoka
www.ashoka.org

ClearlySo
www.clearlyso.com

Social Venture Network svn.org

CREO
www.creo-network.org

Omidyar Network
www.omidyar.com/investees

MEASUREMENT METHODOLOGIES

A Guide to Social Return on Investment (2012)
SROI Network

Data driven: A Performance Analysis for the Impact Investing Industry (2011)
Global Impact Investing Network (GIIN) and Impact Rating Investment Standards

Forum for the Future
www.forumforthefuture.org

Global Reporting Initiative (GRI)
www.globalreporting.org

GIIRS Quarterly Analytics Report (2013)
GIIRS, Ratings and Analytics for Impact Investing

HIP SCORECARD
www.hipinvestor.com/for-companies/hip-scorecards/

Intellectap PRISM (Portfolio Risk, Impact and Sustainability Measurement)
prismforimpact.com

Impact Reporting and Investment Standards (IRIS)
iris.thegiin.org

Leap of Reason: Managing to Outcomes In an Era of Scarcity (2011)
M. Morino, Venture Philanthropy Partners

Making an Impact: Impact measurement among charities and social enterprises in the UK (2012)
E. Ní Ógáin, T. Lumle and D. Pritchard, New Philanthropy Capital

Principles of Good Impact Reporting for Charities and Social Enterprises (2012)
ACEVO, Charity Finance Group, Institute of Fundraising, NCVO, New Philanthropy Capital, Small Charities Coalition, Social Enterprise UK and SROI Network

Social e-evaluator
www.socialevaluator.eu

Social Innovation Europe
www.socialinnovationeurope.eu/search/node/impact%20investing

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www.socialinnovationexchange.org/home

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www.engagedinvestment.com

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A. Hornsby, Investing for Good, London UK

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The SROI Network

TRUCOST
www.trucost.com

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Social Investment Glossary of Terms (2011)
The Centre for Social Impact

The Blended Value Glossary (2004)
E. Bibb, M. Fishberg, J. Harold and E. Layburn, Stanford Graduate School of Business

Other glossaries for impact investment can also be found at:

- Big Society Capital
- Contact Fund
- Human Resources and Skills Development Canada
- Impact Reporting and Investment Standards
- Impact Investments: An Emerging Asset Class (2010, see above)

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