

# Institute for Philanthropy

## Leveraging Charitable Assets

Seminar held on the 9th September 2005  
at 2 Temple Place, London

Financial savvy, commercial nous and a hard-nosed approach to profits are not characteristics always associated with the third sector. In the past, foundations typically donated the income earned on their capital. It's increasingly clear, however, that this funding stream alone is inadequate in allowing foundations to meet their goals, and foundations are pioneering innovative financial techniques in order to maximise their giving power.

The Institute for Philanthropy held a seminar to explore the ways in which charities and foundations are exploiting their assets more aggressively and productively.

Three speakers – **Luther Ragin** of the FB Heron Foundation, **Kurt Hoffman** of the Shell Foundation and **Malcolm Hayday** of the Charity Bank – provided an insight into some of these new approaches.

Luther Ragin discussed how a foundation's capital, as well as its income, could be deployed to assist good causes while, at the same time, ensuring that the capital is not eroded.

Kurt Hoffman spoke about how the business skills of Shell employees can be used to make the foundation's work much more effective.

Malcolm Hayday outlined how the Charity Bank offers a mixture of interest rate return and tax relief to attract depositors, whose funds are then invested in good causes.

To be sure, there are potential risks associated with these approaches. Some will be concerned that the worlds of charitable giving and creative financial engineering simply don't mix, while the tax and legal status of some of these techniques requires further exploration.

We have only been able to include highlights from the seminar in this paper. A full transcript is available on request from [cornelie@instituteforphilanthropy.org.uk](mailto:cornelie@instituteforphilanthropy.org.uk).

### Luther Ragin The FB Heron Foundation

Over a decade ago, the FB Heron Foundation's board of directors decided to explore ways of putting more of the foundation's assets to good use. The board, said Ragin, posed the following question: "Was there an opportunity to engage more of the assets productively and prudently in furtherance of the mission of the foundation?"

The foundation looked to build a diversified portfolio, including below market rate investments, that in total would earn a competitive rate of return while at the same time putting a greater proportion of the foundation's assets to good use.

Ten years later, in addition to the \$10m of grants made every year, nearly one quarter of the FB Heron Foundation's \$275m endowment is committed to mission-related investments such as providing affordable home ownership, enterprise development in disadvantaged communities, and access to capital broadly for low income people.

The foundation invests indirectly, as well as directly, in this field, committing money to private equity funds that target projects within the foundation's remit, such as housing development in disadvantaged communities. "Ten years ago there were no such private equity funds, and now we have \$14 million (5% of the foundation's asset base) invested in eight of them," said Ragin.

Investments in this area are also syndicated as a means of spreading risk. For example, the Calvert Foundation has developed a pooled product called Calvert Community Investment Notes<sup>1</sup> which attracts investment from individuals and some institutions. The investment provides a below-market rate of return but offers the reassurance of a security.

#### Case Study: Yucaipa Corporate Initiatives

*The Yucaipa Corporate Initiatives Fund is a \$600m fund that invests in companies which are located in, serve or employ people from urban or rural underserved communities or that are owned or managed by minorities or women.*

*One of their programmes involves acquiring properties owned, but no longer required, by the US Catholic church.*

*A significant amount of this property is located in disadvantaged, inner-city type areas and is often underused.*

*The property is typically an abandoned school or convent, and can be redeveloped to provide affordable housing, a business centre or community facility.*

*The fund offers a market rate of return that is competitive with investing in a mainstream private equity fund with no social objective.*

The market for these notes is now sufficiently sophisticated that brokers can invest in them electronically alongside any other kind of security.

There are other approaches to the 'securitisation' of community investments. Community Development Banks, for example, allow foundations to make below-market deposits, while the Community Reinvestment Fund<sup>2</sup> purchases loans from charities, pools them and repackages them as a security that can be sold in the mainstream capital market.

The fund has made \$50m of economic development loans over the past 11 years, and is rated as highly creditworthy by an independent ratings agency.

The LB Heron Foundation adopts a rigorous approach for assessing the success of both its market-rate and below market-rate investments. On the market-rate side, the foundation assesses its track record against standard benchmarks, such as the yield on US Treasury bills or the performance of the S&P 500 index of large companies.

"On the below market side," added Ragin, "we establish our own benchmark: long term inflation rate plus one percent from a blended average of the portfolio. At the same time as looking to see how assets are meeting financial benchmarks, we look to see how robustly they meet their social objectives."

Some of the US's largest foundations have formed a network to assist this kind of giving. "We have our own rules for mission related investments, as do other foundations in the US, including the Gates, Ford and Rockefeller foundations<sup>3</sup>. All of these bodies have joined a virtual Project Related Investment (PRI) network which looks to increase and share best practice on below-market projects. These foundations also act as intermediaries to articulate their own values and investment methodologies," said Ragin.

### FB Heron Foundation

[www.fbheron.org](http://www.fbheron.org)

Luther Ragin is Vice President, Investments, at the FB Heron Foundation, a US foundation established in 1992 with an endowment of \$275 million. Their programme guidelines identify five elements of wealth creation strategies for low income people and communities:

- Home ownership
- Enterprise development
- Quality and affordable childcare
- Access to capital
- Comprehensive community development

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*"Financial savvy, commercial nous and a hard-nosed approach to profits are not characteristics normally associated with the third sector."*

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## Kurt Hoffman

### The Shell Foundation

Hoffman described how the Shell Foundation sought to exploit the skills that exist in the Shell group of companies. "We are applying business thinking and business principles to deliver pro-poor services," he said. Shell's experience in areas such as risk management or market research can prove immensely useful in the charitable sector.

The Shell Foundation takes a business-like approach to the projects it supports. "We have a focus in everything we do on financial viability so our investment is always structured around helping the partner achieve financial viability," he said.

Such an approach has two benefits. First, it breaks any tendency towards 'aid dependency' and allows initiatives to grow beyond the levels that can be supported by charitable giving, which, however well intentioned, will never prove sufficient to solve the challenges of acute poverty. Secondly, a commercial approach breeds good discipline in the management of the projects in question. "We've found that by keeping that financial viability as a main requirement it introduces the drivers for innovation, cost-cutting and efficiency that are so important in the market-driven model of wealth creation," he said. He added that those disciplines are vital as organisations grow in scale.

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### Case Study:

#### Gas stoves for India

*Shell worked with an Indian NGOs to provide efficient gas cookers. The initiative had the twin aims of improving both energy-efficiency and health. (Respiratory disease caused by exposure to wood fires is a widespread problem in India). When led by the NGOs alone, the project had foundered because of insufficient manpower and resources.*

*Shell rethought the project and started again with a pilot phase. It seconded procurement and supply chain managers from Shell India as well as relevant management consultants (Accenture Development Partners) to help on the business planning side. It brought in people with marketing, technical innovation, business planning and project management skills, setting them the challenge of establishing a business selling the stoves at no more than \$3, while generating sufficient profit to finance the supply chains, the marketing and social education that goes with the product.*

*The initiative has now sold over 65,000 stoves to families living on \$1-2 a day. The partner NGO now has a business plan that can be scaled up so that, by 2008, it is confident it will have sold at least two million stoves.*

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The foundation invests in business initiatives that would struggle to attract mainstream financing. It has established funds that supply start-up capital to energy-related enterprises that typically lack sufficient assets to raise loans and whose directors lack business training. The funds have invested \$13m in Uganda and South Africa, which have so far posted a handsome 20% return. "That's allowed us to just announce the launch of a \$100 million East African small enterprise fund," said Hoffman.

The success of the model has attracted development finance organisations such as FMO<sup>4</sup> and CDC<sup>5</sup> and Actis<sup>6</sup> who are development bodies but which invest on commercial rates. “If you can prove a model on a small scale that’s commercially viable you can get capital into these markets,” concluded Hoffman.

### **The Shell Foundation**

[www.shellfoundation.org](http://www.shellfoundation.org)

Kurt Hoffman is the Director of the Shell Foundation, an independent grant-making charity registered in the UK with a global focus. It was established in 2000 and its programs support efforts to reduce the impact of fossil fuels, to help poor communities gain access to modern energy and to help them generate income. Since its inception, the Foundation has provided grants and other forms of support to over 80 projects in more than 28 countries. The Foundation has established a \$100 million fund to assist the growth of small and medium-sized enterprises in Africa

## **Malcolm Hayday** **The Charity Bank**

Hayday said that the Charity Bank emerged from the realisation by the trustees of the Charities Aid Foundation<sup>7</sup>, fifteen years ago, that the traditional model of foundations donating income earned from a capital endowment would prove insufficient to meet the needs of the charitable sector.

Also, the trustees recognised a new breed of charitable initiative, dubbed Social Enterprise, which looked beyond grant funding. In many cases, these projects were established by entrepreneurs who wanted financial self-sufficiency rather than grant dependency.

“After a pilot programme we created a unique vehicle that is both a registered charity and a fully authorised bank,” said Hayday. The bank, the only one of its kind with charitable status, takes share capital from trusts and foundations as well as donations from the general public. That capital is then invested in a range of vetted projects.

Hayday said: “The charity sector is a cosy place to be and likes grants, which we do not feel is an efficient way to allocate resources. Charities need to sweat their assets. The Charity Bank has top quality due diligence – we identify organisations with good social values that are also financially viable.”

Individuals can make deposits for as little as 90 days, though the Charity Bank’s own polling shows that depositors are committed for the long term. To strengthen that commitment, the bank produces an annual portfolio of all of the projects it finances, encouraging depositors to get involved directly.

The bank offers depositors a combination of below market rate interest (2%) coupled with investment tax relief (over 8% for a high rate tax payer). “A 10% return in today’s market looks attractive,” said Hayday.

Foundations themselves make deposits in the bank, either managing their own investments or using the bank to carry out due diligence on potential projects. Hayday said that he wanted to tap the mainstream capital markets to create tax-efficient schemes for individual donors, though work remained to be done on the regulatory and tax implications.

### **Case Study:** **From WC to PC**

*A village in Derbyshire had disused public toilets that became a centre for vandalism, drug taking and antisocial behaviour. The residents both wanted to put an end to this running sore in their community and wanted a local police station.*

*A chance discussion with the Derbyshire Police Force led to the Charity Bank financing the £11,000 conversion of the public toilets into a community police station with depositors’ capital.*

*The police have agreed to a five year lease, which will provide sufficient revenue pay off the loan.*

He concluded that UK charities are unfamiliar with the range of financial options open to them, and that part of the bank’s work was to carry out this kind of education. “I think that the UK market place is more typified by latent rather than effective demand for loan finance,” he said, “and part of our obligation is actually to increase the investment readiness of many of these organisations.”

### **The Charity Bank**

[www.charitybank.org](http://www.charitybank.org)

Malcolm Hayday is Chief Executive at the Charity Bank, a non-profit organisation that lends money to charities and community groups. Its charitable status allows it to offer savers tax relief on their deposits which makes it an attractive saving account. It offers a moderate rate of interest which can be returned to the depositor or reinvested in the fund, and deposits can be repaid in full, or reinvested in the Charity Bank or another charity. On the project side, the Charity Bank provides long-term support with a focus on building capabilities. It offers affordable finance and financial services to organisations often unable to access other sources of finance. All deposits contribute to a pooled fund which is then invested by the bank.

## **DISCUSSION**

The three presentations explored ways in which charities are looking beyond donations and grant money and employing increasingly innovative financial techniques to achieve their goals.

Discussion from the floor focused on some of the implications of this shift in behaviour. Lord Browne-Wilkinson, the former Senior Law Lord, queried the possible conflict between raising

funds for charitable causes and seeking to maximise financial return. “You’re talking about mixing up charity on the one hand, and having at the same time benefit, or non-charitable benefit accruing,” he said. He asked how the tax authorities approached this possible conflict.

Luther Ragin said there is a US body of law which relates to programme-related investments and includes them as charitable distributions, Phillip Mind, Senior Policy Advisor, HM Treasury said that in the UK it was an area in need of further study.

Peter Wheeler, Chairman of Futurebuilders<sup>8</sup> raised the question of competition between charities absorbing lessons from the private sector: “There’s presumably a tension between collaborating with similar organisations and competing with them. I wonder how the trade-off works between collaboration and competition, and the extent to which competition actually helps the promotion of these new initiatives?”

Malcolm Hayday said: “I firmly believe that you can’t have a market if you’ve only got one player and I would encourage competition.” Kurt Hoffman agreed that competition was a vital motivating force. “When we place our investments we want the recipients to have the demands of repaying or meeting their finance obligations as a means of getting them to innovate,” he said.

Luther Ragin added: “We look forward to the day when aggressive and active competition becomes something we have to fret about. At this point, frankly, our mission is to increase the number of mission related investors.”

Tom Hughes-Hallett, chief executive of Marie Curie Cancer Care, asked whether there was any kind of advisory shop where charities could learn about financial innovation. Peter Wheeler said that Futurebuilders liked to get involved in projects before the fundraising stage. “We’re not making grants to subsidise loans, but specifically to enable organisations to transition to a more sustainable model,” he said. Futurebuilders has a roster of business advisers that it seeks to match with organisations.

Hayday said: “There are a number of organisations that are beginning to fill the gap. Some of those activities are happening in the area of venture philanthropy. The problem is that most of these missions are actually very small and they need scale and resources behind them.”

Many thanks to Kit Bingham who compiled this paper on behalf of the Institute for Philanthropy

<sup>1</sup> See Calvert Community Investment Notes under [www.calvertfoundation.com](http://www.calvertfoundation.com)

<sup>2</sup> [www.crfusa.com](http://www.crfusa.com)

<sup>3</sup> [www.gatesfoundation.org](http://www.gatesfoundation.org), [www.fordfound.org](http://www.fordfound.org), [www.rockfound.org](http://www.rockfound.org)

<sup>4</sup> The Netherlands Development Finance Company (FMO) works alongside the private sector in developing countries and emerging markets – [www.fmo.nl](http://www.fmo.nl)

<sup>5</sup> CDC Globaleq is an emerging market power company – [www.globaleq.com](http://www.globaleq.com)

<sup>6</sup> Actis is a private equity investor in emerging markets – [www.actis.com](http://www.actis.com)

<sup>7</sup> [www.cafonline.org](http://www.cafonline.org)

<sup>8</sup> Futurebuilders aims to improve public service delivery through investment in England’s voluntary and community sector – [www.futurebuilders-england.org.uk](http://www.futurebuilders-england.org.uk)

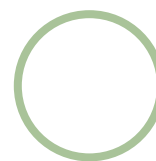
## About the Institute for Philanthropy

The Institute for Philanthropy is a non-profit making organisation. It was set up in 2000 to develop a greater understanding of philanthropy and its place in modern society, and ultimately to allow philanthropy to thrive by:

- promoting research into the incentives and barriers to giving
- devising improved methods for increasing giving
- ensuring that the maximum benefit reaches the ultimate cause.

The unique contribution of the Institute is to promote the profile and practice of all types and levels of philanthropy; it is independent of any particular cause.

Our vision is of a flourishing civil society where all good causes are adequately funded and where there is energy, enjoyment and achievement in co-operative philanthropic endeavour.



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