Achieving Philanthropic Intent with Less

By Jonathan D. Jaffrey

In a world where leverage has become a dirty word, leveraging philanthropic intent stands out as a noble pursuit—one that is increasingly important to our clients and much harder to achieve in today's challenging economic environment. There are many ways to achieve positive leverage in the philanthropic arena. At its simplest, leverage is use of resources so that the potential positive outcome is enhanced. Philanthropic leverage sometimes is defined as a small amount of money given for the express purpose of attracting funding from other sources or providing an organization with the tools necessary to raise other funding, creating a "multiplier effect."

Giving More with Less

Leverage in the philanthropic arena is seen in the U.S. tax structure. Depending on your client's tax bracket, financial leverage of up to 66 percent can be achieved through the use of various nonprofit vehicles. A dollar of appreciated stock donated to a nonprofit can generate approximately $0.40 of useable tax credits.[1] This results in $1 available at a cost of $0.60, or 66-percent financial leverage. This simple use of the tax code allows clients to give more with less. Many, though, are in a quandary about what to do with dollars that have been impacted by the current economic crisis. The good news is all is not lost; there are many ways to give more with less. For an advisor, the first step is to understand a client's philanthropic intent and whether it has changed. This is best achieved through both family discussion and independent meetings with each involved family member. Typically these meetings reveal estate planning, insurance, and other wealth-related issues that may need to be addressed. Changes in these areas may affect your client's philanthropic activities.

Once the philanthropic direction is confirmed, it is time to start employing tools to achieve the client's philanthropic intent, recognizing that the client may be working with less. These tools include mission-related portfolio investing, recoverable grants/program-related investments, credit guarantees, and philanthropic leverage.

Mission-Related Portfolio Investing

"Should a private foundation be more than a private investment company that uses some of its excess cash flow for charitable purposes?" This is the question board members of The F.B. Heron Foundation asked several years ago. Their answer was yes, and therein lies the first technique we can employ for doing more with less. Mission-related investing (MRI) helps bring the full power of our clients' portfolios to bear on their philanthropic intent. The benefit of MRI is that philanthropic goals can be achieved without spending down the portfolio.

MRI may be employed through positive or negative screening to align clients' portfolios with their philanthropic intents (missions). For example, a foundation with a mission to improve health outcomes can emphasize health and safety practices in its proactive screening approach. A foundation with a mission to help build and sustain rural communities can avoid investing in large-scale commercial agriculture. In both cases, the foundations are using their portfolios to achieve a desired outcome without spending. In fact, if properly employed, mission-related investing has been shown to generate returns in excess of non-mission investing, contributing to the health of the portfolio.

MRI can be employed in a proactive approach as well. Foundations can make investments in for-profit or nonprofit organizations such as affordable housing, microfinance, or development of therapeutic drugs. They may invest directly in these organizations or through intermediaries such as loan funds that aggregate social investment opportunities. These investments can offer either market-rate financial returns or below-market returns, sometimes referred to as "program-related investments."

Program-Related Investments

Program-related investments (PRI) are made by foundations (and in some cases donor-advised funds or other philanthropic entities) in support of charitable purposes, with the explicit understanding that those investments will earn below-market returns, adjusted for risk and mission. Although a PRI is not a grant, it does count toward a foundation's payout requirement in the year of distribution. Herein is a tremendous opportunity for doing more with less.

The economics of PRIs can be extremely powerful. In fact, with 4-percent grant-making instead of 5-percent grant-making, a foundation could allocate up to 18 percent of its assets to PRIs, with expected financial returns equal to or greater than the conventional 95/5 scenario.[2] PRI strategies like this one can result in increased funds allocated to achieving philanthropic intent without spending down the portfolio. It might be counterintuitive that the PRI strategy (allocating 18 percent of assets) is superior for foundation wealth building. It is, however, because assets that would have been given away instead are invested. If these investments are successfully returned, they increase the foundation's future giving capacity.

Foundations that engage in a PRI strategy also are building capacity by perpetually expanding the availability of funds, creating a stronger incentive to better manage the recipient relationship and the endeavor (because a positive return is at stake), and, in some cases, even shaping the way capital markets operate. For example, Lee Zimmerman is co-owner of Evergreen Lodge (www.evergreenlodge.com) in Yosemite, California, and a benefactor of a PRI. When Mr. Zimmerman and his partners purchased the lodge in 2001, they wanted to contribute something meaningful to the community and they needed funding. Through an investment by The Roberts Foundation, they achieved both by establishing a program for high-potential youth from urban backgrounds. Over the years, that program has been widely regarded as a success. Mr. Zimmerman has delivered on investor expectations by paying dividends as projected. PRIs can be made in economic development, housing, education, health care, social services, the arts, and other areas.

Credit Guarantees

A credit enhancement, or loan guarantee, is an arrangement by which a foundation or other philanthropic vehicle or individual agrees to repay a loan with interest if the borrower defaults. The benefit of this arrangement is that the guarantor does not actually pay out any funds unless the borrower defaults, allowing the achievement of the philanthropic intent again without reducing the portfolio. This technique is becoming popular in today's reduced giving environment. Nonprofit organizations with declining revenues are looking for short-term loans to fill the gaps until giving rebounds. By obtaining a loan guarantee from an individual or foundation donor, that organization is able to access much needed funds but does not require the guarantor to spend from the portfolio.

My firm recently assisted a nonprofit in obtaining a loan to bridge a cash shortfall. The nonprofit lacked assets to guarantee the loan, so it approached past supporters for a loan guarantee. The past supporters, though unable to provide the needed funds, recognized that the nonprofit had a strong track record that would make repayment likely and were willing to provide loan guarantees. With these guarantees, a local bank provided the necessary loan on terms beneficial to the nonprofit—a win-win for everyone.

Philanthropic Leverage

In addition to the techniques discussed above, philanthropic leverage can be obtained by making gifts that, by their nature, attract or allow an organization to raise additional funds. In an economic downturn the need for philanthropic leverage is crucial because the relative value of a gift is diminished. Funds can be given to hire additional development staff or to fund communication programs that are likely to bring in funds in excess of their cost. It is more important than ever, before giving, to meet with and understand the needs of the nonprofit organizations to ensure your client's dollars will go further.

One example of philanthropic leverage is The Gates Foundation's attempt to "leverage" big pharmaceutical companies' research budgets by giving incentives to encourage spending on the development of a vaccine for malaria (which kills millions) rather than a cure for baldness (which merely wounds vanity).

Such techniques can be applied by clients of any size. Gifts can be made requiring "matching funds," giving the recipient a tool for raising funds from others. Clients also can collaborate by pooling dollars with like-minded givers, aggregating resources to benefit their causes. For many this takes the place of fundraisers or meetings to educate and solicit others to support their causes. For advisors, this is a wonderful opportunity to bring together clients who have a common purpose; it brings benefits to both client and advisor (e.g., potential new client introductions).

Philanthropic leverage and the other techniques discussed here differ from the Wall Street kind of leverage that contributed to the current financial crisis. Expect philanthropic leverage to become more important as social demands increase and government budgets tighten; the need to get the maximum impact for the increasingly scarce philanthropic dollar will grow. Explore these techniques with your clients, as well as other nonfinancial ways to help them achieve philanthropic intent.

Jonathan Jaffrey is chief executive officer and founding partner of Springbanc Social Capital Advisors; previously he was chief operating officer/chief financial officer for the W. M. Keck Foundation, a $1.4-billion private foundation focused on science, engineering and medical research, liberal arts education, and community programs in Southern California. He earned a BS in finance and communication from the University of Arizona and an MBA from the University of Southern California. Contact him at jdj@springbanc.com.

Endnotes

1. This example approximates the benefit a California resident would receive for making a charitable gift to a qualifying entity under specific circumstances and is presented for example purposes only. You should seek advice from an independent tax advisor based on your particular circumstances.
2. Assumes 8-percent returns to a portfolio (not including PRIs), 2-percent net returns to a diversified PRI portfolio, and –100-percent financial returns from grant-making. The financial return to a portfolio not including PRIs (95 percent invested, 5 percent in grant-making) is 2.6 percent under these assumptions [(.95 * 8%) + (.05 * –100%) = 2.6%]. However, a 1-percent allocation to PRIs and a 4-percent allocation to grants boosts expected return to more than 3.6 percent. In fact, with 4-percent grant-making instead of 5 percent, the "breakeven" PRI allocation (where expected financial returns are equal to the conventional 95/5 scenario), is 18 percent. Calculation provided by Trillium Asset Management Corporation.