About NCRP

The National Committee for Responsive Philanthropy is an independent nonprofit organization founded in 1976 by nonprofit leaders across the nation who recognized that traditional philanthropy was falling short of addressing critical public needs. NCRP’s founders encouraged foundations to provide resources and opportunities to help equalize the uneven playing field that decades of economic inequality and pervasive discrimination had created. Today NCRP conducts research on and advocates for philanthropic policies and practices that are responsive to public needs.

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A Call For Mission-Based Investing
By America’s Private Foundations

By Rick Cohen

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Introduction and Summary

Thumbing through *Foundation News & Commentary* and the *Chronicle of Philanthropy*, even the most jaded foundation CFO and disinterested program officer would stumble across articles about social investment, program related investments (PRI), and socially responsible investment screens. The concept of foundation charitable endeavors through mechanisms other than grants is hardly new, with innovative uses of PRIs and other investments emerging regularly. A little historical research might suggest that the first PRI in the United States came from the fertile mind of Benjamin Franklin, who dedicated 2000 pounds to establish a revolving fund for young artisans, a concept that would today probably be touted in the *Chronicle* as a foundation innovation.

The annual reports and website information of the F.B. Heron Foundation constitute a real-life case study of a foundation’s deeply thoughtful strategy for investing a significant proportion of the institution’s assets in mission-related nonprofit ventures. A download of the list of Heron’s mission-related investment beneficiaries provides examples and ideas that could kindle new investment strategies of foundations large and small across the nation.

Some of the how-to’s are easily accessible to the casual reader of the philanthropic literature. For the more adventurous, exploring Heron’s PRI guidelines and the language of the MacArthur Foundation’s Request for Proposals (RFP) for its Affordable Housing Preservation Initiative are as instructive as any instructional manual. The foundation
progenitors of the practice of PRIs, the Ford Foundation and others, have written boatloads on the practice, abetted by a bevy of private consultants willing and able to assist foundations about to re-jigger their asset investment strategies to more closely align with their missions.\(^4\)

Notwithstanding the foundation sector's awareness of alternative investment strategies, or at a minimum, at least the awareness of the coterie of large foundations, it is still clear to even the most casual observer that foundations place the bulk of their assets in corporate investments. They bank on their abilities to ride the market roller coaster upward for maximum total return and sidestep the plunges that occur during downturns, aiming for the maximum financial return on their shareholdings without much or any mission-specific lens. In the most recent bear market, equity-dependent foundations lost billions, dollars that they might not have lost had the funds been invested in community loan funds, low-income housing developments, or tax increment financing packages.

Why devote foundations’ tax-exempt billions to the Enrons, Tycos, Parmalats, ImClones, and their corporate peers whose returns are regularly exposed as inflated and spurious, with deleterious effects for individual and institutional shareholders? Why put foundation moneys behind the likes of Nike and the Gap, whose corporate policies underlie many of the socio-economic conditions that foundations committed to social change are trying to reverse? What seems to prevent foundations from devoting solid slices of their assets to investment in the activities of nonprofit entities that can produce returns, not the speculative returns of high tech corporations, but generally reliable returns nonetheless with the dual benefit of supporting the social policies and objectives of the foundations themselves?

This paper presents an argument for a different kind of foundation investment strategy. It is not predicated on the good idea smorgasbord approach to foundation practices—presenting a list of attractive options to consider and hoping that the philanthropic reader will select samples to taste and ultimately replicate. Instead, we present a strategy for foundation organizing, to be championed and directed by foundation executives and officers, that will induce and support their peers in looking at their assets as active capital assets for the nation’s more than 1 million nonprofits.
This paper recommends the following:

1. Foundations can and should devote portions of their investment dollars to support mission-related ventures of nonprofits.

2. Foundation investments should go beyond issuing PRI loans to a myriad of more creative options, including the provision of equity-like capitalization for nonprofits.

3. Foundations can and should devote a portion of the billions they spend on investment advisors to capitalize an intermediary organization or several intermediaries to pool and invest foundation assets for mission-related purposes.

4. Considering foundations can hew to a line that requires a minimum of 5 percent of assets going toward foundation spending, foundations should devote a comparable benchmark of 5 percent of foundation assets to mission-based investing.

Mission-Based Investment Options

The fastest growing sector of socially responsible investing is community development financial institutions (CDFIs), whose total assets reached $14 billion in 2003. While impressive and exciting, this statistic must be seen as reflecting the assets of the nation’s entire collection of community development credit unions, community development banks, and community development loan funds, all of which have been available for investments from institutional pension funds, private banks, and foundations. The role of foundation capital in that total is but a sliver. It is indicative of what foundation investments could do to provide significant reusable resources for multiple parts of the nonprofit sector.

Creative foundations have devoted investment dollars to a variety of alternative investment vehicles beyond CDFIs, with more in the offing for the creative foundation investment officer. Any listing of mission-based investment options, however, runs the risk of two problems. On one hand, there is the problem of nonprofits being established or expanding product lines to fit the philanthropic “flavor of the month.” If foundations discover CDFIs as the preferred mission-related investment vehicle, suddenly lots of nonprofits develop CDFI lines. On the other, there
is foundation herd mentality, flocking to put money behind the CDFIs they have discovered, perhaps through the high profile of a CDFI leader who has caught the attention of some key foundation leaders. Suddenly CDFIs are the investment and PRI focal point, when in reality there are a number of potential mission-related investment options foundations could and should consider. Therefore, the following list of common and less common foundation mission-based investment options is not meant to be comprehensive, nor to favor one option over another, but simply to highlight potential mission-based investment potentials for foundations, more than just the default choices of CDFIs known to most people in the sector.

**Program Related Investments**

Program Related Investments (PRIs) are the best-known investment option. PRIs simply make money available to nonprofits in the form or low-interest or no-interest loans or other investment instruments. Foundations are not meant to be bankers and cannot issue PRIs with the expectation of significant income generation from interest rates or property appreciation, but can issue PRIs in the form of loans, social purpose deposits, loan guarantees, lines of credit, equity investments, and recoverable grants, the bulk of which are discussed later in this paper, if the intent is truly philanthropic. More than half of PRIs, however, are in the form of loans.

Although a tiny foundation by most standards, the F.B. Heron Foundation is unquestionably the nation’s leader in mission-based investments through PRIs. Heron actually distinguishes its mission-related investments into three categories: program related investments (amounting to $14,305,000 in 2002, mostly in the form of loans and lines of credit, plus some equity in investments in limited partnerships), insured deposits with community development credit unions and community development banks ($3,700,000), and other mission-related investments ($24,000,000). Heron’s 2002 PRIs include the following:

- A $500,000 eight-year loan to the National Community Capital Association, the national trade association of CDFIs, to provide flexible financing for NCCA members
- Payment of $250,000 of a $750,000 commitment made in 2000 for deposits in rural community development credit unions through the National Federation of Community Development Credit Unions
• A seven-year $500,000 senior loan to the Reinvestment Fund in Philadelphia for enterprise development

• A $250,000 five year loan to the Sustained Excellent Alliance Corporation to fund the predevelopment activities of ten nonprofit homeownership housing developers

The list of recipients of Heron PRIs is virtually a catalogue of top-flight nonprofits warranting foundation loans: the Boston Community Loan Fund; the Cascadia Revolving Fund; Coastal Enterprises located in Wiscasset, Maine; the Community Loan Fund of New Jersey; Manna, a community development corporation in Washington DC; the Illinois Facilities Fund, which finances human service facilities, multi-service centers, day care centers, etc.; the Housing Assistance Council, which works on rural development issues; the Self-Help Ventures Fund in Durham, NC, which is a widely respected source of financing for low-income housing and community facilities, including charter school facilities; the New Community Corporation in Newark NJ, which develops and manages thousands of units of housing in addition to a shopping center, a business incubator, a day care program, and employment training programs.

With more resources at its disposal than Heron, the Ford Foundation adds a zero to the size of its highlighted list of PRIs, and many go to specific on-the-ground nonprofits in addition to intermediaries: $1 million as working capital for the jazz programs of the Manchester Craftsmen’s Guild at the Manchester-Bidwell Corporation, $1.5 million to the Enterprise Corporation of the Delta as a secondary market for mortgages that do not meet the standard secondary market criteria, $2 million to Neighborhood Housing Services of Chicago for a loan fund to assist low-income homeowners, and $1.5 million to finance the acquisition and renovation of office space for the Puerto Rican Legal Defense and Education Fund.

Even in the Heron list of PRI recipients, a significant portion of PRIs goes to Calvert, the Housing Assistance Council, the Illinois Facilities Fund as opposed to flowing directly to community-based nonprofits themselves. Information from a decade ago showed that the top PRI recipients in community development tended to be intermediaries such as the Local...
Initiatives Support Corporation (LISC) and the Enterprise Foundation, both of which basically substitute their on-the-ground investment knowledge for the investment decisions of the foundations themselves.8

**Equity-like Investments and Recoverable Grants**

Loans are debt, usually collateralized against some kind of property, in the case of housing and economic development projects or some pledge of future revenues, as in the instances of foundations advancing short term loans against projected revenues or committed but not yet received government payments. The alternative is making money available as “recoverable grants” which function like equity investments. The Patient Capital Fund for Neighborhood Commercial Real Estate Development in Boston is an excellent example of the concept. The fund provides “equity-like” investment, which its LISC sponsors describe as having the following characteristics:9

- The investments are in projects which through rigorous underwriting are expected to be viable.
- However, the investments are high risk, possibly not recoverable at all, certainly not before most or all of the debt is repaid or refinanced.
- Nonetheless, the sponsor is expected to repay the investment.
- The investor does expect some return on investment as well as the repayment of the investment.

One observer describes patient capital as “equity, but with a twist...(a) new product (that) can be thought of as the equity equivalents for nonprofit organizations, …as near equity, that is, debt with equity features.”10 Because many proponents of patient capital aim for investments from for-profit entities such as banks and insurance companies, the emphasis seems to be on high-risk projects undertaken by high-performance nonprofits. Foundations might be in a position to take even higher risks and invest their patient capital in nonprofits that are not yet the widely recognized “‘winners’ in the industry—those organizations that are high performers and high yield social impact providers”,11 but also those with emerging track records but large
potential socio-economic benefit upsides. Distinguishing foundation investors from for-profit providers of patient capital goes back to the legal structure of PRIs in Section 4944 of the IRS Code, mandating that PRIs have charitable purposes as their primary motivations—not generating income.

Recoverable grants or forgivable loans should be an important resource made available by foundations. Why are these important to nonprofits? First, they are important sources of capital that are needed before long-term funding sources have been identified or secured, particularly front-end project costs or “predevelopment” costs. Second, they are unsecured and used for projects that involve substantial risk, with the prospect that they may never be repaid. Third, in general, they are not available from most conventional funding sources that generally require recipients to pay back the funding and require loan security. Fourth, recoverable grants frequently can be made with little or no interest charges. A number of entities currently provide recoverable grants for predevelopment costs, which foundations could easily assist through additional capitalization or provide recoverable grant support on their own. Examples include:

- The Ohio CD Finance Fund Child Care and Head Start Planning Grants (predevelopment grants for child care and Head Start facilities, up to $10,000 loans)

- New Jersey Community Loan Fund Jump Start for Child Care redevelopment loans for child care centers, up to $20,000, no interest, 18 month recoverable grants)

- The Community Asset Fund Business Planning Advance Program (developed by the Enterprise Foundation and NCB Development Corporation, making available forgivable loans for community facilities projects in 17 target cities, ranging from $25,000 to $30,000 with no formal cap, but an interest rate of 6 to 7 percent)

- The Community Economic Development Assistance Corporation (forgivable loans for affordable housing and child care facilities, from $5,000 up to $500,000 at 5 percent interest)

- National Community Investment Fund (recoverable grants to help create community development financial institutions, paying for regulatory filings, physical plant, etc., up to $250,000)
Why consider equity-like investments? Because that is what many nonprofits need. With the impact of the Community Reinvestment Act and the incentives for banks to support CDFIs through the Bank Enterprise Act, CDFIs can obtain loan funds to reloan to nonprofit grantees in many cases, but they also find themselves with the need to support equity investments in their communities.

**Working Capital**

The Ford Foundation and the MacArthur Foundation as leaders in the PRI movement dwarf the Greater Miami Community Foundation in asset size, but this community foundation has developed an attractive model of making working capital loans to Miami-Dade County cultural and art organizations. It makes short-term loans, between three and nine months, at a 2 percent interest rate for a number of gap financing purposes including the following:

- Advance funds for organizing a benefit
- Paying for development or public relations consultants, including consultants preparing grant applications
- Guaranteeing short-term loans from other lenders
- Bridge funding between the close of one season and the income from subscriptions for another

Named the “Miracle Program,” because the proceeds for the revolving loan fund came from the opening of the Miracle Center entertainment complex, the Miami Community Foundation’s program demonstrates at least two important dimensions of non-grant funding for nonprofits.

One is that the focus and recipients of PRIs need not always be housing and economic development organizations or even large nonprofits. The Miami beneficiaries of this revolving loan fund are small, grassroots, storefront arts organizations. All too often PRIs are thought of primarily as loans or investments of hundreds of thousands of dollars to nonprofit behemoths the size of LISC and the Enterprise Foundation or in the arts, the Corporation for Public Broadcasting. The $5,000 revolving loans made available to small arts groups in
Miami shows a way that smaller foundations can provide important capital resources to small organizations.

Increasingly, other foundations are providing short-term gap financing for nonprofits. In Washington, D.C., the Meyer Foundation, for example, offers cash flow loans of up to $75,000 from a pool of $1 million to bridge the gap between nonprofits’ government contracts and foundation grants and the actual receipt of funds. The Foundation charges no interest on the loans from the Nonprofit Cash Flow Loan Program, but does take a 2 percent service charge up front.

The experience of nonprofits trying to survive both the pressures of September 11th in New York City and the travails of charitable and philanthropic funding cutbacks in the years since has demonstrated that many of the problems could be seen in the time between nonprofits’ incurring expenses and receiving reimbursements. Government reimbursements are notoriously slow and made the survival of nonprofits difficult during the huge pressures of responding to 9/11 service demands.13

Sometimes, these investments can function as lines of credit for nonprofits engaged in the early stages of project development, the “predevelopment” stages that conventional sources of financing are reluctant to support due to their risk and uncertainty. A report that encouraged Harvard University to devote part of its endowment to neighborhood development carried out by local nonprofits explained the predevelopment financing challenge succinctly:

Producing affordable housing is a long, arduous process. Affordable housing producers often must obtain predevelopment capital from three or four sources; most of which require demonstration of site control as a loan condition. Even after achieving site control, developers must face another three to six months before closing on their construction loans. During this process housing prices are escalating at two percent a month in certain neighborhoods, adding considerably to a developer’s transaction costs. Moreover, developers seeking to acquire property often cannot compete with for-profit developers with better access to working capital. Potentially affordable properties can be forever lost to the speculative market.18
For-profit Subsidiaries of Nonprofits

Anyone who has experienced the growth of the nonprofit community development sector is aware of the impetus of the Low Income Housing Tax Credit instituted with the enactment of the 1986 Tax Act. Community development corporations (CDCs) and community development intermediaries established for-profit subsidiaries and equity pools for the development of low-income housing and the syndication of tax credits to investors. While some investment schemes have teetered precariously close to the boundaries of nonprofit ventures, and some disreputable entities established sham ventures that have been challenged in state and federal courts, for the most part, the sector has come to see the utility of for-profit subsidiaries as business development vehicles for nonprofits. The problem is that many nonprofits have little front-end capital to put toward the creation and operationalization of their development subsidiaries, some finding themselves motivated to tap into other dedicated revenues that are supposed to be used for other programs.

The investments need not even be in the for-profit subsidiaries of nonprofits. MacArthur has provided loans to the Woodcutters Cooperative for a sustainable harvesting project, the Markle Foundation has purchased stock in the MultiMedia Corporation, and MacArthur again has loaned money to the First Non-Profit Risk Pooling Trust, to provide insurance for nonprofits. Investments in independent for-profits unrelated to the activities and strategies of nonprofits are certainly dicey and do not add to the capital access of nonprofits, but they are a mission-related investment option that can be considered, particularly in areas or regions where the nonprofit sector simply is not generating the kinds of programs that foundations can support with these sources of risk capital.

Market-rate Deposits

Decades ago, public sector leaders innovated with the concept of “linked deposits.” Facing banks that were reluctant to invest in inner city neighborhoods, municipal and state leaders decided to add to their criteria for selecting depositories the notion that banks holding government revenues should be making affirmative investments through mortgage and rehabilitation loans in inner city and low-income rural communities. The link is simply the
connection between the deposit of government funds, for example, pension funds, building funds, and specific tax revenues, and the promise of the banks holding the funds to invest them in projects benefiting specific target constituencies, communities, or organizations. It is not hard to see the parallel in the PRI practice of the Heron Foundation making deposits in for-profit community development banks, including minority-owned banks, such as City National Bank of New Jersey; Douglass National Bank of Kansas City, MO; Elk Horn Bank & Trust in Arkadelphia, AR; and Chicago’s pioneering Shorebank. These deposits of $100,000 each enable these community development banks to make more inner city housing and business loans as well as increase their net worth for the purpose of leveraging additional capital. Foundations larger than Heron might consider such deposits not only to be used as community financing resources, but also to leverage more aggressive community financing from banks that are currently reluctant to do so.

In some cases, these are investments meant to serve as a secondary market for loans issued by or to nonprofit entities. The purpose of secondary market financing is fundamentally to manage portfolio risk and increase liquidity. In the case of lenders to nonprofits, they find that their loans to nonprofits cannot be sold or securitized and marketed to secondary market investors because of the perceived risks of nonprofit (or nonprofit-like) ventures. Entities such as Fannie Mae, Freddie Mac, and Ginnie Mae may serve as a secondary market for some relatively high-risk loans that banks cannot sell elsewhere, but there is no secondary market for lenders to nonprofits because even Fannie and Freddie with expectations of more than reasonable returns on investment require some elements of standardization in characteristics of the loans they buy, their underwriting, and their servicing. Foundation investors willing to devote parts of their portfolios to secondary market functions could enable community development banks such as Shorebank and others to step up their nonprofit financial commitments if they had the certainty that there were institutional investors willing to purchase the loans.

Secondary markets and securitization have bolstered the growth of home mortgages, car loans, and credit card debt by helping lenders increase liquidity and reduce transaction costs. “Concessionary investors” such as foundations that do not need to earn market returns can open doors for conventional lenders to provide financing for nonprofit sources such as CDFIs,
loan consortia, and others. The model might be one of the securitization proposals of the Financial Institutions Roundtable, which has proposed the creation of pooling mechanisms for CDFI loans, much like the way Low Income Housing Tax credits are pooled for syndication, and a community development financial guarantee corporation that would credit-enhance CDFI loan pools.19

**Tax Increment Financing**

Tax increment financing “is a method of funding public investments in an area slated for redevelopment by recapturing, for a time, all or a portion of the increased tax revenue that may result if the redevelopment stimulates private investment,” with bonds usually sold at the front-end of the project that are retired by the increased tax revenues.20 Chicago, Minneapolis, Kansas City, and other municipalities have been expanding the focus of Tax Increment Financing (TIF) districts from downtown development to neighborhood development. Compared to downtown developments, where the likely appreciation in real estate values and taxables prompts for-profit investors to purchase TIF bonds, neighborhood developments often lack competitive market attractiveness. Frequently what is needed to get a TIF financing deal going for a neighborhood development is the willingness of a concessionary investor to make an initial purchase. Essentially, the nonprofit investor—the foundation—could provide a loan to the redevelopment entity designated to carry out the targeted neighborhood improvements, for example, in Washington’s Columbia Heights neighborhood, the development of the historic Tivoli Theater as a supermarket and shopping center, and be repaid over time by revenue notes issued by the municipal government or designated developer backed by the anticipated increases in property tax values in the area. In some cases, the foundation investor could lend to the development entity a portion of the funds that would otherwise have to be backed by TIF bonds, thereby reducing the necessary size of the TIF bond issuance and increasing the attractiveness of the TIF bonds to for-profit investors. The Tax Increment Financing Neighborhood Improvement Fund in the Bronzeville and Woodlawn neighborhoods of Chicago is an example of a TIF loan pool capitalized by a mix of TIF bond proceeds and nonprofit investor loans.

Why would a foundation be interested in a neighborhood development-oriented TIF project?
Consider a neighborhood TIF just one type of economically targeted investment (ETI), where a foundation can provide credit enhancement, co-financing, or subordinated financing to attract and leverage the participation of conventional investors. The concept for ETIs in the 1990s was typically focused on pension fund investments, where relatively progressive state and municipal finance leaders, particularly in Pennsylvania, California, and New York, pressed for substantial ETI investments by public pension fund managers. Because pension funds have a constituency of retired workers who look at their funds’ investment decisions as risking their future income, the pension fund ETI performance has been inconsistent, especially after some pension funds made questionable investments in real estate ventures that did poorly in the late 1980s. A speculative investment in a TIF to develop and convert a long abandoned theater in Northwest Washington might not be an attractive investment to people counting on the long-term revenue of an investment fund, but a foundation should be able to take that kind of risk with the reward being a catalytic development project capable of turning around an entire neighborhood.

**Moving the Foundation Investment Portfolio**

It is nearly impossible to find two treatises on foundations that use the same count of the number of private foundations or the assets they control, much less analysis that has a strong handle on foundation investments and foundation performance on PRIs. The Foundation Center typically refers to a number of 65,000 or so grantmaking foundations, both private and public, other observers put the number over 70,000, and the Internal Revenue Service counts over 83,000 private foundations, although many are undoubtedly nonprofits that failed to meet their public support tests. The Foundation Center usually puts the total endowment assets of foundations at close to $500 billion, though the increasing numbers of new foundations and the continuing ascent of the Standard & Poor’s, Dow, and NASDAQ indices suggest assets well above that amount.

Overall, nonprofit endowment assets, including foundations, universities, and hospitals, easily top $1.3 trillion, though some estimates including institutional investors such as pension funds put the tax-exempt endowment total at some $7.3 trillion. While there have been some losses in
endowment values in 2001 and 2002, for the most part, foundation assets as well as the investment assets of other large nonprofits have grown hugely over the past decade. Simply examining the growth of the value of securities owned by nonprofits between 1993 and 1998, one is struck not only by the enormous average annual growth, but the implicit recognition that this is growth concentrated in large nonprofits, given the vast number of smaller nonprofits that can barely eke out enough money to meet payrolls, much less make purchases on the NYSE or NASDAQ.  

<table>
<thead>
<tr>
<th>Type of nonprofit</th>
<th>5-yr. annual growth rate in value of securities (1993 to 1998)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All nonprofits</td>
<td>16.1%</td>
</tr>
<tr>
<td>K-12 education</td>
<td>25.9%</td>
</tr>
<tr>
<td>Clinics</td>
<td>34.0%</td>
</tr>
<tr>
<td>Environment</td>
<td>20.0%</td>
</tr>
<tr>
<td>Higher education</td>
<td>17.2%</td>
</tr>
<tr>
<td>Philanthropy</td>
<td>16.1%</td>
</tr>
<tr>
<td>Museums</td>
<td>15.3%</td>
</tr>
<tr>
<td>Performing arts</td>
<td>16.4%</td>
</tr>
<tr>
<td>Housing</td>
<td>20.3%</td>
</tr>
<tr>
<td>Seniors</td>
<td>15.2%</td>
</tr>
<tr>
<td>Hospitals</td>
<td>16.9%</td>
</tr>
<tr>
<td>Mental Health</td>
<td>18.6%</td>
</tr>
<tr>
<td>Employment</td>
<td>19.3%</td>
</tr>
<tr>
<td>Community</td>
<td>25.1%</td>
</tr>
<tr>
<td>improvement</td>
<td></td>
</tr>
</tbody>
</table>
Nonprofits’ participation in the ownership and investment of $1.3 trillion in endowment assets,\textsuperscript{26} not to mention investment in land and equipment, among other big ticket items, indicates the resources at the disposal of the sector to make for a better functioning nonprofit capital market. As a sector, nonprofits have failed to marshal their assets as effectively as the for-profit sector has mobilized and leveraged its assets, notwithstanding the for-profits’ continuing Enron-, Freddie Mac-, and Xerox-type overvaluation scandals. In many cases, foundation investors have lost money on their private corporation bets, as have the vast majority of investors in the stock market. Investors in CDFIs may not have harvested huge financial returns, but data from the National Community Capital Association indicated in 2001 that CDFI investors had never lost a cent of their investment capital.\textsuperscript{27}

Think of the $500 billion that resides in foundation endowments as a part of the capital market dedicated to the nonprofit sector. Remember that the other revenues available to nonprofits, for example, government grants and investments, may exceed the flow of capital from foundations to nonprofits on an annual basis, but are available to nonprofits and for-profits alike. Foundation wealth, at least in theory, is devoted to serving the nonprofit sector.

While foundation grants go largely to nonprofit entities, foundation investments go into the stock market, aiming for maximum return with relatively little concern for the social impacts of their corporate investment partners. Less than 15 percent of surveyed members of the Council on Foundations report using social investment screens of any sort to guide their corporate investments, though interestingly, smaller foundations with assets under $10 million were twice as likely to use investment screens than large foundations with assets over $100 million.\textsuperscript{28} The reality is that for the most part, foundation investment screens are relatively simplistic, for example excluding investments in companies producing tobacco-related products, involved in gambling, or manufacturing guns and ammunition. Few foundations use more complex social responsibility screens that address more complex and controversial issues of human rights and labor issues.\textsuperscript{29} Fewer still take advantage of their corporate holdings to engage in shareholder actions putting corporate policies under the microscope of public scrutiny.\textsuperscript{30}

Estimates of the proportion of funds under professional management in the U.S. that have
been invested in socially responsible manners (screened portfolios, shareholder advocacy, community investment, etc.) vary widely, though the Social Investment Forum (SIF) put the proportion at 13 percent in 1999. Given that the SIF estimate accounts for all funds, estimated to be $16.3 trillion, under professional management, it is not difficult to imagine that the socially responsible proportion for foundations can and should easily double or triple the 13 percent benchmark, beginning with mission-related investments in nonprofit and related for-profit ventures.

Data suggests that only $232.9 million of foundation assets were awarded in 2001 as PRIs compared to $30.5 billion in grants, an increase of 3 percent over the 2000 figure. This represented less than .05 percent of foundation assets at that time. The Foundation Center lists only 225 foundations making PRIs in the two-year period of 2000 to 2001, 135 having made PRIs larger than $10,000. Less than 4 out of every 1,000 foundations made a PRI during that period. While foundation assets dropped during that two-year period, they dropped due to investments in the stock market, not because of losses in community development financial institutions or low-income housing financing.

Foundation PRI issuers ranged across foundation asset ranges, as demonstrated in this table of PRI funders by asset size in 2000-2001:

<table>
<thead>
<tr>
<th>Asset range</th>
<th>No. of foundations</th>
<th>Dollar amount of PRIs ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1 billion+</td>
<td>7</td>
<td>$125.7</td>
</tr>
<tr>
<td>$250m-$1b</td>
<td>20</td>
<td>$89.7</td>
</tr>
<tr>
<td>$50m-$250m</td>
<td>50</td>
<td>$122.8</td>
</tr>
<tr>
<td>$10m-$50m</td>
<td>34</td>
<td>$63.4</td>
</tr>
<tr>
<td>Under $10m</td>
<td>24</td>
<td>$19.6</td>
</tr>
<tr>
<td>Total</td>
<td>135</td>
<td>$421.1</td>
</tr>
</tbody>
</table>
There is no indication in this chart that the asset size of foundations constitutes a reliable predictor of foundation willingness to make PRIs. With the art or science of PRIs relatively well-known in the industry, the barrier is neither awareness nor assets. If so few foundations can find their way to making low- or no-interest loans to nonprofits in the form of PRIs, the prospects for a more aggressive regime of investment of endowment assets in nonprofit instruments would appear to be limited unless bold steps are made to create sectoral vehicles to make mission-based investment a more practical option.

Awareness of the investment potential of foundations crept into the public consciousness with the hotly debated report of the McKinsey Company, with the publication of “The Nonprofit Sector’s $100 Billion Opportunity.” Provoking a brouhaha as large as the number of people who failed to read it, the McKinsey article generally called for a rethinking of the mobilization of foundation assets and notably suggested that “social investing” of foundation endowments “could reap both social and financial returns on their investments.” This analysis generally follows a McKinsey piece issued in 2002 to the effect that foundations are essentially very conservative investors, with the result that “building the endowment appears to have become an end in itself.”

It is difficult to imagine that building ever bigger endowments is the primary motivation of foundation program staff, whose skills and emphases aim toward social mission fulfillment. Rather, one must assume that endowment building as an end in itself, maximizing financial investment returns as an overarching goal, is the goal of the foundation staff and consultants charged with protecting the nest egg for perpetuity, the foundations’ investment managers.

During the nation’s recent debates around the level and composition of private foundation qualifying distributions or payout, some foundation spokespersons pointed out the shortsightedness of critics calling for more grants and failing to call for more aggressive, socially responsible foundation investments. If foundation payout at 5 percent is worthy of debate, foundation PRIs at less than .05 percent hardly constitutes an adequate defense.
Making Mission-Based Investment Happen

The overall picture is one of foundations with large amounts of capital failing to make it reasonably accessible to the nonprofit sector whether in grants or loans or other kinds of investments. Foundations control half a trillion dollars largely for investment in corporations without bothering to exercise an iota of shareholder action powers or putting the capital to use for tax-exempt purposes other than building foundation endowments.

Turn the situation on its head. Foundations represent a capital pool available for mobilization and investment in nonprofits, partially through grants, though easily done at more than 5 percent per year, and significantly more through loans and investments. Sitting on tax-exempt capital invested in corporate equities, foundations are inadequately serving their nonprofit constituents. The investment capital of foundations should be available to nonprofits as the first tier, the most easily accessible tranche of the nonprofit capital market. How can foundations reposition themselves to become the doorway to a functional nonprofit capital market, both providing capital from the billions currently capitalizing for-profit corporations and leveraging government and private capital?

What stops the foundation sector from mobilizing its investment assets directly in support of their philanthropic missions? Part of it has to be that foundation program staff, to whom mission achievement rather than capital return should be a prominent goal, do not understand much about nonprofit financing. No, that isn’t to say that they don’t understand nonprofit finances. It doesn’t take huge technical mastery to read the standard nonprofit finance textbooks or attend nonprofit workshops to learn how to read a nonprofit’s audited financials. While many of us in the nonprofit sector still have to write explanatory memoranda to some foundations explaining basic concepts like indirect costs and overhead rates, for the most part, most foundation staff members can figure out how to navigate a nonprofit budget and understand revenues and expenses. But they haven’t understood or experienced financing. As a result, they know how to give a grant—though as Ed Skloot notes, foundations consistently nickel and dime their grantees even though they know that the result is a systemic nonprofit undercapitalization. But they don’t know how to finance a deal, read a pro forma, assess a market, and truly grasp concepts of leverage and equity investment.
Everyone has some exposure to financing. We carry loads of credit cards, take out car loans, and even get mortgages for home purchases. But most people haven’t experienced the world of finance, of accessing and mobilizing capital, sometimes in large sums, for organizational or development interests. It is why in the community development field, both CDCs and national and regional intermediaries are so frequently dipping into banking for staff recruitment—and why banks are so eager to mine community development nonprofits for talent.

The default option is training. Let’s identify and train the thousands of staff people working for major foundations and turn them into financiers. Philanthropy is an industry that is exceptionally supportive of in-service training, though which of the 17,821 foundation staff people working for 3,360 staffed foundations should be trained or might actually benefit and use the training is hard to determine. Since two-thirds of staffed foundations function with only one or two staff members, it would be a process of training people for functions and skills that they might not use repeatedly, and without focus or emphasis, use technically well. Unfortunately, a foundation training program on nonprofit financing, while undoubtedly a worthwhile addition to the agendas of the sector’s many conferences is a completely incremental, unsystematic process for changing the investment behavior of institutional philanthropy.

Were philanthropy to embark on a major emphasis of sector-wide mission-related investment, a more likely result would be the hiring of a new layer of foundation staff to become financing experts, if the function can even be pried away from the foundations’ in-house or out-of-house investment professionals. But again, with 8 out of 10 staffed foundations employing 4 or less staff, not necessarily even professional staff, the vast majority of foundations will end up as bystanders.

Rather than the methodological incrementalism of individual foundations creeping toward mission investment strategies one-by-one, this is one area where the creation or bolstering of intermediaries makes a great deal of sense. Although the field of philanthropy relies on intermediaries in many forms, there has been relatively little research on how to construct intentional intermediaries to fulfill important cross-institution sectoral needs. Rather, existing research is thin and descriptive rather than analytical and action-oriented.
Szanton’s study of intermediary organizations (IOs) tends to focus on intermediaries that carry out the functions that foundations do reasonably well, but fails to address the more out-of-the-ordinary functions that intermediaries might be able to take on on behalf of foundations. Szanton makes his focus on the grantmaking functions of intermediaries clear from the beginning:

*Foundations have much to gain by using IOs, both in grantmaking convenience and impact on the fields they target. The potential tactical benefits of IOs (for grantmaking convenience) include speed, reduced staff costs, lowered visibility on potentially controversial issues, the judgment of independent outsiders, access to experts who could not necessarily be employed directly, credibility, and eased program exit.*

In Szanton’s research for the Foundation Center, the potential of intermediaries to carry out functions which are outside the typical expertise of foundations, as opposed to simply making grantmaking flow better, receives short shrift. He emphasizes in great detail “the benefits of grantmaking convenience” and “greater openness to unconventional grants,” but overlooks non-grantmaking strategies. Even when the paper touches on grantees whose functions make them attractive candidates for investment as well as grants, such as CDFIs, the ability of intermediaries to open up new sources of capital to such institutions emphasizes grants as capital, not PRI loans or investment capital, much less financial innovations for reshaping the nonprofit capital markets. Like most analyses of intermediaries, the study starts with the Ford Foundation’s creation of LISC, but misses the notion that LISC’s huge contribution to the community development field was not simply its aggregation and regranting of foundation and corporate grant dollars, but its innovations in mobilizing other kinds of capital investment in nonprofits—multiple loan products including predevelopment loans and recoverable grants, investment options through syndications of the Low Income Housing Tax Credit (through the National Equity Fund) and non-tax credit investments in neighborhood supermarkets (through The Retail Initiative), and secondary market vehicles for community development loans (through the Local Initiatives Managed Assets Corporation).

What might an intermediary function do to facilitate foundation investment in nonprofit organizations—beyond grantmaking? A financial intermediary can be structured to function between the nonprofit and foundation spheres as a vehicle for legitimizing foundation
endowment investment in nonprofits and for bridging the capital needs of nonprofits and part of the $500 billion in capital assets of foundations. In tracing the history of community development intermediaries, for example, Liou and Stroh note that even the early intermediaries such as the Community Assistance Fund (CAF) and the Institute for Community Economics were interested in creating multiple instruments for capital investment in nonprofits, with CAF emphasizing its function as a vehicle for foundation PRIs.41

Considering the success of contemporary financial intermediaries such as LISC and the Enterprise Foundation, both of which have increasingly expanded their financing missions past narrow definitions of affordable housing to leverage investments from corporate and individual investors, why create an intermediary for the investment of foundation endowment assets in mission-based structures? There are several possible rationales:

1. Even the community development intermediaries are limited in both the kinds of financing they will make available and the risks they will assume. In part, it is because they are facing for-profit investors who expect not only to receive their principal repaid, but also to earn a return on investment. Sometimes the returns are not necessarily small, as in the case of tax credit syndications or the original 10 percent cash-on-cash return offered by LISC's Retail Initiative, even if below what investors could earn through other investment scenarios. The loss rates on LISC and Enterprise loan portfolios are astoundingly low, and both intermediaries have to hold large amounts of their balance sheets as collateral against book loans, to further shield the investors and lenders that have fronted money to the intermediaries. There is some evidence that CDFIs, for example, are using their for-profit equity sources for the “no-to-low risk portion(s) of the(ir) portfolio(s)”42 and if they are too dependent on bank and corporate capitalization, for example, CDFIs will not be taking the kinds of investment risks that they can and should. Using endowment assets for investment, foundations could absorb expectations of lower returns with less of the financial protections required by banks or individual investors.

2. The for-profit capital markets that LISC, Enterprise, and others access
on behalf of their nonprofit networks require some significant demand and volume predictability, even if with less predictability than the capital sources would require if investing in the sector on their own. Without for-profit capital market pressures, a foundation working through an investment intermediary might not need or require the kinds of predictability and certainty that for-profit investors expect from loan fund or CDFI prospectus. Using endowment assets as the “risk capital for social change” is a logical role for foundation investments lacking the hard bottom-line constraints of for-profit investors.

3. As a sector, foundations have frittered away a resource to their for-profit partners that might be of inordinate value if spent on the capacity of nonprofits. As foundations typically calculate their expenses, they allocate 0.5 percent of their assets annually, as a rule of thumb, for investment costs. That sum is largely spent on for-profit investment managers who sink foundation assets in corporate stocks. If the roughly $30 billion that foundations granted to nonprofits in 2001 represents 5 percent of foundation assets, 0.5 percent of assets could be something in the range of $2.5 to $3 billion spent on investment managers. If foundations were to think of devoting a portion of that $3 billion as resources to spend on building a new highway for nonprofits to access the capital investment potentials controlled by foundations, it could be a major step toward facilitating the flow of nonprofit capital to mission-related rather than mission-disconnected investment options.

4. Some foundations have a social Darwinist approach to grantmaking. Paul Lingenfelter, a former vice president of the MacArthur Foundation and an innovator in the field of PRIs, once described the typical foundation approach as follows:

When you make a grant, the message you give is that the grantee is supposed to spend the money and come back for more when that money is gone. When you make a loan, you expect the organization to remain viable and financially sound so that it can pay you back.
Too many foundations do not take it as their responsibility to focus on the survival and advancement of their grantees, simply the expenditure of the grant funds according to intent. A lending relationship seems to add a psychological as well as financial commitment between the lender and the borrower, making the foundation PRI-issuer committed to the financial health of its nonprofit partners. This is not simply a foundation issue, but a grantmaker issue. When a half dozen of the major community development corporations of Milwaukee all serially collapsed and went bankrupt in a brief period of time during the mid-1990s, one of the major community development financial intermediaries refused to intercede, despite having established an office in Milwaukee to build and sustain the local nonprofit community development sector. The intermediary’s representatives contended that because the intermediary had not been involved in the financing of any of the CDCs’ development projects, it had no obligation to step in to save or restructure the organizations or the hundreds of dwelling units they had financed—even though many of the CDCs had participated in the intermediary’s capacity-building training programs in the city and even received small amounts of seed grant funding. Perhaps it will take a shift in the perspective of foundations from benevolent grantmakers to full financial partners with their nonprofit constituents to get foundations to rethink their tendency individually and collectively to systematically undercapitalize nonprofits. One result, for example, might be that foundations that make loan or equity investments in nonprofits might come to better understand the significance of flexible core operating support grants to the long-term financial health of their grantees.

Clara Miller of the Nonprofit Finance Fund suggests that the problem of nonprofit capital liquidity is due to “inappropriate capital structure”, that is, “the size and mix of (nonprofits’)… long- and short-term assets and liabilities”.

The problem of nonprofit capitalization structures is not simply a reflection of nonprofits’ “single-minded” focus on program delivery and “neglect (of) the business side” of their operations, but a response to where the money is. Government agencies by and large fund service delivery, individual donors donate in response to heartstring issues and impact. Foundations as potential institutional investors can and should fund not just to make grants for nonprofits to spend, but to comprehensively support and develop their nonprofit constituents. They have grants to deploy, hopefully in flexible core support mechanisms that allow for nonprofit institution-building.
During the Clinton Administration, Secretary of Labor Robert Reich became an active proponent of pension funds investing in Economically Targeted Investments (ETIs). Reich issued investment guidance in the form of Interpretive Bulletin 94-1, which called on pension fund managers to consider investments “selected for their economic benefits apart from their investment return to the employee benefit plan.” Despite controversy among Clinton and Reich critics, who bemoaned the propensity of ETIs to support affordable housing and called on pension recipients to demand maximum investment returns, ETI investment strategies have taken hold, particularly in several state pension funds. For example, several states considered and adopted legislation based on a model promoted by the Center for Policy Alternatives to direct 5 to 10 percent of pension funds to ETIs, generating a potentially huge capital pool for social investment, while diverting only a small proportion of pension fund assets to these lower return investment options. Foundations need a model as well, telling them what would be a reasonable minimum swath of their endowments that can and should be devoted to mission-related investments.

As a British observer noted, foundations and other endowed charities “have had it drummed into them that, when you are investing charity money, you have to get the best possible return.” The alternative is a social impact policy that maximizes the societal benefit of all of the foundation’s resources, not simply focusing on its grantmaking and ignoring the contrary impacts of its investments. If foundations can flock to a 5 percent spending rate, which for some but not enough of the better foundations translates to 5 percent of endowments devoted to grants, there is no reason why foundations could not devote a similar proportion of their endowments as a rule of thumb for mission-related investment. Taking the most recent numbers on foundation grantmaking, that would be $30 billion in investments matching $30 billion in grants. Anything less, as current foundation investment and PRI behavior demonstrates, shortchanges the nonprofit sector and diminishes the potential of institutional philanthropy.
Endnotes

1 The Hewlett Foundation’s Jed Emerson, formerly with the Roberts Enterprise Fund, has been a prolific contributor to these debates, particularly his “Horse Manure and Grantmaking.” *Foundation News & Commentary* (May/June 2002).


4 Brody Weiser Burns is among the leaders, with several strong publications on the practice, including Francie Brody, Kevin McQueen, Christa Velasquez and John Weiser, *Current Practices in Program-Related Investing* (2002).


7 Heron’s other mission-related investments include commitments to private equity funds for investing in real estate partnerships and business investment funds, both having obviously for-profit direct beneficiaries or even for-profit sponsors, but with inner city investment returns.

8 A cursory review by the National Housing Institute concluded that intermediaries received 39 percent of the dollar values of community development oriented PRIs between 1990 and 1992, cf. “Measuring the Market”, *Shelterforce* (September/October 1996).

9 Greater Boston LISC, “Equity/Patient Capital Investment to Support Non-Residential Development” (n.d.).


12 Kirsten Moy and Alan Okagaki, “Changing Capital Markets and Their Implications for Community Development Finance”, *NCG Reports* (Spring 2002).


14 Recipient of a $2,000,000 PRI from the Ford Foundation for working capital to help public broadcasters compete more effectively with national media competitors.

15 One dimension of this in the September 11th context was the need for help for organizations that were directly affected by and displaced by the World Trade Center terrorist attacks. While organizations might be able to qualify for assistance from the Small Business Administration and FEMA, they needed cash loans to bridge the gap in SBA and FEMA assistance and grants and loans to “carry the non-reimbursable portion of their need and loss” that FEMA and SBA wouldn’t cover. Cf. Clara Miller’s memorandum to 9/11 funders, “Nonprofit Recovery Needs: Quick Assessment of Demand and Supply of Aid to NYC Nonprofits” (September 20, 2001).

16 Opportunities for Partnership in Affordable Housing (Harvard University, Office of Community Affairs, 1999).
Frances Brody and Scott Miller, *Foundation Investments in For-Profit Enterprises* (Brody & Weiser, 1998).


Based on data from a 1993-1998 panel of IRS returns from the Statistics of Income (SOI) sample.

Public grantmaking foundations, not private foundations.

For housing and community improvement nonprofits, presumably the growth of securities portfolios represents their involvement in Low Income Housing Tax Credit syndications and perhaps in purchases of securitized mortgages issued by Fannie Mae and Freddie Mac.

The chart displays nonprofit assets beyond endowment values. According to Federal Reserve Board Flow of Funds Accounts sectoral balance sheets, the total wealth of nonprofits in 1998 was $2.928 trillion, of which $1.777 trillion was “financial,” $1.059 trillion was in real estate, and $92.0 billion (rather than trillion) was in nonprofit equipment.

*CDFIs: Bridges Between Capital and Communities: 2001 Member Statistics and Information* (National Community Capital Association), p. 3.


Among social investors, tobacco is the most common factor in social screens, followed by gambling, alcohol, weapons, and the environment. Only half as many social screens include human rights and only one-third or so include labor issues, according to the Social Investment Forum’s 1999 SRI Trends Report (http://www.socialinvest.org/areas/news/1999-trends.htm).


The largest PRI recipient during that period was the government of Armenia, followed closely by the Nature Conservancy, both with roughly $17,000,000 in PRI authorizations.


Paul J. Jansen and David M. Katz, “For Nonprofits, Time is Money”, in *The McKinsey Quarterly* (Number 1, 2002).

Ed Skloot’s analysis of the systematic foundation undercapitalization of nonprofits is well described in his “Slot Machines, Boat Building, and the Future of Charity”, in *Responsive Philanthropy* (Spring 2002).

The Foundation Center’s count of 17,821 staff people working for 3,360 foundations in 2003 is based on a survey of 20,716 foundations with at least $100,000 in giving or assets of $1,000,000 or more. See *Foundation Staffing: Update on Staffing Trends of Private and Community Foundations* (2003).

Szanton, p. 18.


“Obstacles to the Capital Markets for CDFIs, CDCs, & RLFs in Virginia, Maryland, Washington D.C., WV” (Wall Street Without Walls, July 2003).


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