IRI Working Paper

Rural Mission Investing: The Role of Foundations in Catalyzing Social Investment Markets that Benefit Rural Communities

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More for Mission
Initiative for Responsible Investment

Abstract:

Rural mission-related investments offer foundations an opportunity to utilize the totality of their resources to promote their mission, whilst serving underserved communities and supporting market development that leverages other forms of capital to a more socially beneficial purpose. While foundations that chose to invest in this way face the risk of lower returns, higher transaction costs, and the greatest barrier of non investable communities, opportunities for investment persist within this growing ecosystem in support of mission investments including the creation and growing prevalence of investment vehicles such as credit unions, CDFIs and loan funds with targeted economic development as their focus. Through the concentrated efforts and continued advocacy for public policy support and the continued aggregation of information regarding opportunity and performance, investment in rural communities and the responsible investment field as a whole stands to continue to grow in the upcoming years with foundations leading the charge.

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Introduction

Mission investing (MI) is an investment discipline that foundations can use to create social benefits within the context of rigorous investment decision making. MI has received increased interest in recent years from the philanthropic community, as seen in the growth of organizations like More for Mission (www.moreformission.org), a research and advocacy organization of 96 foundations with over $39 billion in assets under management, and its sibling organization PRI Makers Network (www.primakers.net), a membership organization that provides education and technical support for foundations engaged in mission investing, particularly the use of below-market investments to create social benefit. This increased interest has supported the development of new double- and triple-bottom line investment products across asset classes, as well as new efforts at grantmaking, as well as investment, that support the development of social investment platforms that leverage other sources of public and private capital.

The development of mission investing reflects the particular role that foundations can play in the larger (and growing) community of investors – from retail investors and high-net worth individuals to large institutional investors such as pension and sovereign wealth funds – who focus on investments with positive social and/or environmental attributes. In particular, the development of organizations such as US SIF (www.ussif.org), the Global Impact Investment Network (www.thegiin.org) and the United Nations Principles of Responsible Investment (www.unpri.org) suggests the expanding universe of investors who incorporate social and environmental information and targeted outcomes into their decisions. Foundations have issue- and sector-specific knowledge, connections with community and nonprofit organizations, and potential flexibility on the kinds of investments they make, all of which can allow them to play a key role in the development of a more robust social investment infrastructure that leverages this broader community.

Within the field of mission investment, rural mission investing presents a specific set of challenges and opportunities for the philanthropic community. There is an established subgroup of foundations who focus on vital rural needs such as sustainable economic development, poverty alleviation, and the provision of infrastructure, goods, and services. Through MI, foundations can direct increased financial resources and capacity building tools to rural areas, and they may also use MI to attract significant new sources of public, private, and non-profit investment to areas that have experienced declining investment, philanthropic and otherwise.

This working paper draws from interviews with foundations, investment intermediaries, family offices, high net worth individuals, banks, credit unions, and others engaged in mission investing or related activities in rural markets. It seeks to place the rural focus in the context of broader market activity in the mission, impact, and responsible investment communities.

Why Mission Investing?

The general arguments in favor of mission investing can be boiled down into three claims:

- Foundations have the capacity to use the entirety of their resources to achieve their mission
- They can use their investments to reach communities underserved by conventional markets
- They have the potential to support market development that leverages other forms of capital to more socially beneficial purpose

Arguments against mission investing often focus on capacity issues, such as:

- The search for social benefit distracts investors from maximizing returns
- Foundations lack the internal capacity to make identify successful double- and triple-bottom line investments
- The investment ecosystem does not ("yet" some might add) support mission investment products
- Targeted communities may not be "investable" – that is, they may not have the tools necessary to translate their need for resources into effective demand for investment capital that will be returned with a targeted premium
- Transaction costs for identifying, managing, and measuring triple bottom line returns may outweigh benefits.

Recent years have seen many foundations develop successful track records that call such skepticism into question, as many foundations have developed track records of success. The ecosystem supporting mission investments, especially among investment intermediaries and other service providers, has grown substantially. Nevertheless, foundations entering the space must consider whether they have the time and resources to develop strategies, policies, and processes to manage a relatively new discipline. Questions of risk, return, and underwriting capacity are fundamental to practicability.

Particularly in innovative sectors or with underserved communities, the tools of investment management – which favor regularized data, conventional benchmarks, and familiar styles – may disfavor investments with outsized social and environmental impact. Building a substantial pipeline of opportunities to support a mission investment practice – achieving reasonable economies of scale – can be harder in mission investing than elsewhere. Mission investors face the problem of identifying investment opportunities that fall within the scope of their specific institutional purpose – a narrowly defined view of geographic region or social problem that a particular foundation wishes to address may preclude investment opportunities that don't precisely match the social profiles that foundations desire.

Mission Investing in Rural Areas

A focus on rural mission investing highlights some of the challenge of translating mission investment strategies into practice. Investing in rural communities

heightens many of the challenges faced by mission investors when evaluating potential strategies and investments. Practitioners note, for example that:

- Rural communities may lack the resources and infrastructure to convert need into effective demand
- Investors with track records tend to work in urban areas, leading to unfamiliarity with rural opportunities and a reluctance to engage
- Aggregating enough deals in a pipeline can be difficult over large, sparsely populated geographic areas

Some of the most developed areas of community investing in the United States – say, for instance, affordable housing development or lending to nonprofits to expand services and capacity – have developed in urban areas in part because of an existing resource base among the nonprofit (often community development) community, the proximity of investors with an interest in and capacity to address specific places, and the ability to aggregate deals of a number and size to attract investor interest. These factors all combine to mitigate the barriers to mission investing market development.

Investing in rural communities may draw into starker relief those barriers. One measure of this is the relative concentration of community investment intermediaries – the vehicles foundations tend to use to implement their mission investing strategies – in urban areas. Foundation investors and intermediaries have suggested that smaller communities located at significant distances from financial centers can make rural investing (or appear to make it) more difficult in terms of being able to source deals and deploy capital. Similarly, these stakeholders frequently note a relative underdevelopment of rural investment infrastructure – investment intermediaries, community partners, public support. Much of the discussion around rural mission investing, then, centers on creating the capacity to take investment capital and channel it to socially productive uses.

Practitioners engaged in rural mission investing also make clear the information asymmetries and cultural barriers that lead to missed opportunities for rural investment. While the infrastructure needs are often real, they can be compounded by misconceptions about investment opportunities and overestimation of investment risks.

Practitioners also note that rural mission investing offers an especially powerful role for foundations in creating investment opportunities in underserved communities, often seen as their fundamental purpose. Those foundations focused on rural communities may have the intellectual and social capital – close contact with people and organizations in places unfamiliar to mainstream financial institutions, or the ability to offer patient capital, technical assistance and capacity building, the credibility, experience and skill to address problems that manifest over the course of an investment cycle – that offers mission investors outsized opportunities to develop markets. They can provide the information, tools, and leverage needed to catalyze investment.

Finally, there is the issue of scale. While it may be more difficult to aggregate investments in rural areas, there is also the potential for relatively small amounts of

money – in the overall scheme of U.S. financial investment – to have particular value in rural communities for economic development and other forms of mission impact. One of the common criticisms of mission investment is that foundations do not have enough money in their endowments to make an impact in broader markets. While this argument may underestimate the benefit that foundations can create with mission investments, both directly and by leveraging public and private resources, it is even less the case in rural communities. Indeed, foundations and individuals may have the flexibility to make smaller sized investments that larger institutions will not.

Market for Rural Mission Investing

The current market for rural mission investing is not particularly deep, but there are opportunities across asset classes and different sectors which offer opportunities for philanthropic investment.

These include traditional community investment vehicles such as:

- Low income credit unions and community development financial institutions in rural areas which use their capital deposits to lend to individuals or small businesses in their area. (Example: Southern Bancorp, based in Little Rock Arkansas, concentrates lending in poor communities in the Mississippi Delta: www.banksouthern.com).

- Loan funds that target economic development opportunities including small business lending, manufacturing or industrial support, or transitional development in underserved communities. (Example: Coastal Enterprises Inc. provides small business lending in rural Maine: www.ceimaine.org).

- Loan funds that provide capital to a broad set of community assistance such as childcare, education, low income housing, and human services. (Example: IFF, a community development financial institution (CDFI) serving five states in the Midwest, includes lending to nonprofits providing services to rural communities in its broader portfolio: www.iff.org).

- Venture capital private equity investments that make smaller investments than traditional equity funds which are more manageable for the entrepreneur and provide more sustainable growth opportunities for the business. (Example: Invest Northwest, a private equity fund created in response to an RFP from the Northwest Area Foundation, invests in late stage companies in rural areas in an eight state region in the Northwest with goals of job creation and economic development: www.investamericaventure.com/funds).

These various forms of investment cover a variety of mission focuses, though they tend to concentrate their efforts on economic development, job creation, and access to affordable housing in rural communities. They may come in the form of targeted rural investment products, or in funds that make an effort to include rural investments as a substantial part of their overall portfolios.

The mission investment community has also begun to focus on sector specific opportunities that are not exclusively rural investments but can have a rural focus or impact. For instance:

- The field of sustainable agriculture, and meat and dairy production, has seen increasing interest in recent years. Mission investors have supported loan funds for smaller farms in rural areas, placed cash deposits in banks and credit unions that serve farmers, and targeted in particular the production of products tied specifically to a place and/or to organic production. This is often closely tied to work on healthy food/communities in urban areas. (Example: RSF Social Finance has created a PRI Food and Agriculture Fund that includes both production and food access as focuses: www.rsfsocialfinance.org/services/investing/pri).

- Investing in the health sector can have specifically rural implications, including loans to support the introduction or expansion of health facilities in underserved areas, or venture capital investments in technologies such as offsite diagnostic equipment that can lower the costs of treating patients in rural communities. (Example: The California Healthcare Foundation Health Innovation Fund makes venture capital investments meant to improve access to care in underserved, including rural, communities: www.innovations.chcf.org).

- Alternative energy investments, particularly in solar and wind power, have the potential to offer rural job creation opportunities or alternative income streams for rural landowners. (Example: Confluence Philanthropy has facilitated the development of the New Mexico Native Green Fund, a below-market loan fund that supports green infrastructure projects on tribal lands in New Mexico: www.confluencephilanthropy.org/?page=NMPRI).

- Land conservation and ecosystems services investments also can create jobs, support sustainable land management practices from forestry to eco-tourism, and facilitate transitions to new forms of economic activity in rural areas. (Example: Lyme Timber supports sustainable forestry practices that match conservation criteria with job development goals: www.lymetimber.com).

We can identify two different impacts of this sort of sectoral innovation. First, it offers foundations with a rural focus the opportunity to use new tools to achieve impact in their targeted areas – new ways to do work they are already focused on. Benefits include a more sustainable use of resources, as well as an investment framework that may encourage sustainable growth by investees as they come to rely less exclusively on grants. Second, sectoral innovation can bring new sources of capital to bear on rural areas – in particular, practitioners see the potential for environmental investments associated with carbon mitigation or land preservation as ways to bring new capital into rural economic development.

Note that these sectoral innovations in mission investing follow trends in public policy, consumer preference, and investor interest. Advocates for rural communities are adapting the trends to the specific needs of rural communities.

The Role of Foundations in Accelerating Rural Mission Investing

Foundations have a special role to play in capital markets, as public purpose entities with substantial private capital, and as institutions with the resources and mission to promote social benefit. Philanthropic investments can create direct impacts – the provision of affordable housing or health clinics, good jobs and clean energy – and those investments can build capacity in investees, investment intermediaries, and asset owners alike, to help develop a sustainable, resilient mission investment ecosystem.

Within the rural mission investment community, deployment of patient capital, support for the development of effective intermediaries, technical assistance providers for investees, and pipeline development systems that lower the cost of information, are all important themes for field development, as they are in all areas of mission investing.

In interviews with mission investors and related stakeholders, several additional themes have emerged as important roles for foundations to play in supporting capital market investment that has identifiable social benefits for rural communities:

- *Build place-based communities of practice*: though rural communities do not necessarily have the infrastructure and resources of urban counterparts, they often do have extensive communities of people and institutions with an affective tie to place, who might be called upon to support the development of mission investment markets with human and patient financial capital investment. Foundations can play a role in developing these communities of practice, building networks through convening, information sharing, and matchmaking where appropriate. A love of place can bring investment skills and resources to bear on areas that the market may not otherwise serve.

- *Adopt an ecosystem approach to rural mission investing*: Mission investment requires a developed set of stakeholders within the public, nonprofit, commercial, and financial sectors, all of whom should be coordinated around a common vision for social outcomes. Foundations can help build platforms that bring the stakeholders together via communities of practice as mentioned above. They can also coordinate financial or capacity-building investments in rural communities across the potential chain of consumers beyond those communities, for instance by linking sustainable agriculture investments with the provision of healthy foods in urban settings. Financial investment alone is unlikely to have lasting impact, without a shared vision and attention from multiple sectors that extends beyond the immediate target of investment.

- *Invest in rural investment infrastructure*: Patient capital is a key element to a successful investment. It may take several years to build an intermediary that can efficiently develop strategies and opportunities, or absorb investments from private, public, and/or non-profit sources. The full range of foundation tools may be most effective in catalyzing intermediaries' development.

- *Aggregate information about investment opportunities and performance*: As noted, transaction costs for rural investments can be high, and there are also potential misreadings of risk and opportunity by those unfamiliar with rural areas. Foundations can help reduce those costs by identifying pipelines of potential investment opportunities. They can address information asymmetries and fallacies by supporting studies of investment performance, and aggregating public, private, and non-profit sector data for researchers and investors to use.

- *Advocate for and help coordinate rural mission investing public policy*: Mission investing, and impact investing generally, are often closely linked to policy initiatives that reduce risk, increase or channel capital flows, or create investable entities. Foundation have a special role to play in exploring and advocating for public policies, say in the health or clean energy or energy efficiency sectors, to extend to rural communities, or to build public procurement strategies that support economic development in rural communities. Foundations can also play an important role in coordinating multiple public policies, or linking investors, investees, and public sector officials, in ways that leverage available public money to best effect.

In Sum

Rural mission investing is a field in need of catalytic development. It offers real potential to substantially increase the resources to improving life in rural communities, and the barriers to rural mission investing are very much the sorts of barriers that foundations are in theory built to address. Engaging in rural mission investing, conscious efforts to build capacity, and using convening and advocacy to build resilient markets, are all within the reach of the philanthropic community, and they are paths for leveraging substantial public and private attention and investment to good effect.

Advocates who work to build sustainable rural communities would do well to encourage foundations to reach their potential to build market ecosystems that create positive social returns.