




New Frontiers
in
Mission-Related
Investing





The F.B. Heron Foundation was created in 1992 with the mission of helping people and communities to help themselves. The Foundation supports organizations with a track record of building wealth for low-income people and communities.


Specifically, the Foundation provides grants to and invests in organizations that promote the following five wealth-creation strategies for low-income families in urban and rural communities:

 advancing home ownership;

 supporting enterprise development;

 reducing the barriers to full participation in the economy by providing quality child care;

 employing comprehensive community development approaches with a strong focus on the Foundation's wealth-creation strategies; and

 increasing access to capital.

Additional information on these program strategies can be found in our Annual Report or on our website, www.heronfdn.org.

- ▶ **Assets as of 12/31/03:**
\$258 million
- ▶ **First-time Grant Range:**
\$25,000–\$50,000
- ▶ **Annual Grant Range:**
\$25,000–\$125,000
- ▶ **PRI Range:**
\$250,000–\$1,000,000
- ▶ **Insured Deposits:**
\$100,000 per depository institution (may be higher if depository is a member of the Certificate of Deposit Account Registry Service network)
- ▶ **Uninsured Deposits:**
Up to \$250,000 per depository institution
- ▶ **Market-Rate Mission-Related Investments:**
Up to \$2.5 million per investment

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NEW FRONTIERS IN MISSION-RELATED INVESTING

“Should a private foundation be more than a private investment company that uses some of its excess cash flow for charitable purposes?”

This was the question that the Board of Directors of the F.B. Heron Foundation posed several years ago as it considered how best to use the Foundation’s assets to promote its mission of helping low-income people and communities build assets and create wealth. The question was a provocative one because it challenged one of the prevailing orthodoxies of organized philanthropy—the belief that mission is best served by constructing a “wall” between program and investment management, with the latter seeking to maximize financial return (usually without consideration of mission) and the former dispensing grants for mission. In 2003, private foundations managed assets of nearly \$500 billion while providing grants of \$29.7 billion in accordance with IRS charitable distribution requirements. The question above, answered in the affirmative by our Board, has shaped our thinking and practice ever since.

The issue for the F.B. Heron Foundation is not whether private philanthropy has done well, but whether it can do better. Specifically, can a private foundation prudently make investments from its endowment that support its mission

without jeopardizing the value of that endowment and, consequently, its ability to support that mission in the future? And, can investments that support mission increase the impact of a foundation’s work, its express reason for being, thereby increasing the *total return* to a foundation’s current and future beneficiaries?

In the last six years, the Foundation has attempted to answer, empirically, those two questions. Of course, six years do not a longitudinal study make, but it can suggest some preliminary lessons that we are pleased to share with the field. In doing so, we welcome the feedback and suggestions of our colleagues and stakeholders whose thoughtful encouragement and advice have often guided our steps.

THE CHALLENGE OF DEAL FLOW

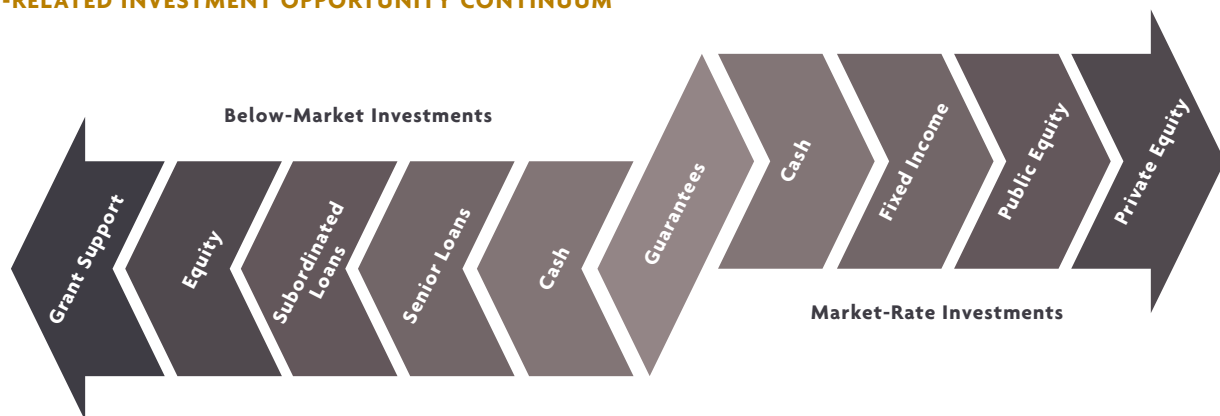
The largest challenge we faced in our mission-related investments was whether there were sufficient investment opportunities aligned with our mission to justify our journey. Frankly, in the beginning we were doubtful. Today, the answer is clearer: in the field of community development there are a variety of good

investment opportunities across asset classes and return hurdles that not only align with our mission, but can increase the impact and reach of our work. By the end of 2003, mission-related investments and commitments comprised 19% of our endowment.

EXPANDING THE PHILANTHROPIC ‘TOOLBOX’

Often these new investment opportunities arise from some of the groups that we have worked with historically, groups that increasingly are gaining financial sophistication and discipline. Where in the past we had one tool in our philanthropic “toolbox”—grants—today that toolbox includes grants, insured and uninsured deposits, senior and subordinated loans, guarantees, fixed income securities and private equity. Some offer below-market returns (program-related investments), but most offer risk-adjusted market rates of return. Foundation staff is challenged to work with nonprofit and for-profit groups to consider what tool or tools permit a group to maximize its impact consistent with the Foundation’s wealth-creation strategies, return expectations and risk parameters.

MISSION-RELATED INVESTMENT OPPORTUNITY CONTINUUM



“The construction of a mission-related portfolio requires a commitment to bring an investment discipline to all aspects of our work.”

For example, we provide grants to technical assistance providers that build the capacity of community development credit unions to meet the credit needs of their low-income members, but we also provide market-rate and below-market rate deposits and secondary capital to the credit unions themselves to increase their capacity to lend. We provide grants to nonprofit housing groups that seek to make home ownership affordable to larger numbers of low-income people, but we also purchase asset-backed securities issued by Habitat for Humanity to expand its self-help housing programs and AAA-rated taxable municipal bonds that provide “soft-second mortgages” for low-income, first-time homebuyers. We provide grants to community-based organizations that seek to revitalize inner city and rural communities and attract business investment, but we also invest in private equity funds that provide needed equity for commercial real estate projects in these communities (often in cooperation with community-based groups) and financing for businesses seeking to expand in or relocate to these communities.

Examples of typical investments follow this essay.

FINANCIAL RETURN AND RISK

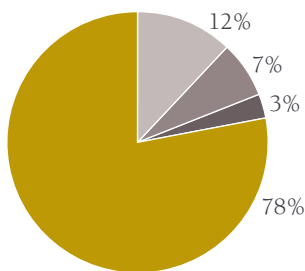
Many readers are no doubt asking themselves—what about financial return and risk? The Foundation has established performance benchmarks for each asset class in its mission-related portfolio. For example, the benchmark for deposits is the national average for two-year jumbo deposits as reported by BanxQuote. In 2003, our mission deposits earned a weighted average return of 2.27% compared to 1.53% for the benchmark. The benchmark for fixed-income securities is the Lehman Brothers Aggregate Bond Index, the broadest measure of the US fixed-income market. In 2003, our mission-related fixed-income portfolio (90% of which is investment grade) produced a total return of 4.04% compared to 4.10% for the benchmark. Portfolio volatility (as measured by R-squared) was 0.84 compared to 1.00 for the benchmark. The benchmark for private equity is the Venture Economics’ US Private Equity Performance Index. Since

all investments we have made in this asset class have been of recent vintage (2000 or later), there have been relatively few realizations to date. Finally, for program-related investments (PRIs) the benchmark is the long-term inflation rate + 1%. In 2003, the weighted average interest rate for our PRIs was 2.9% compared to the benchmark of 3.2%. The Foundation’s goal is to meet or exceed these performance benchmarks over time for each asset class.

MAINTAINING INVESTMENT DISCIPLINE

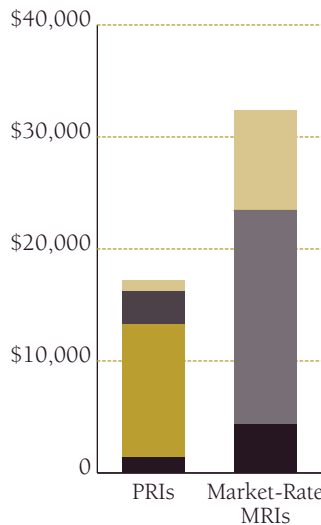
The construction of a mission-related portfolio requires a commitment to bring an investment discipline to all aspects of our work. This has meant significant training and development for both our program and investment staff. It has also meant the creation of new networks of third-party due diligence providers and investment advisors, and heightened engagement and learning for our Board and Investment Committee. These costs—both financial and human—are not insignificant. They have been largely offset,

Overall Asset Deployment



- Traditional Corpus: \$203,050,000 (at 12/31/03)
- Market-Rate MRIs: \$32,439,000 (including commitments)
- PRIs: \$17,178,687 (including commitments)
- Grants: \$8,647,426 (2003 payout)

Mission-Related Investments Asset Allocation (dollars in thousands)



Allocation	PRIs	Market-Rate MRIs	Total
■ Cash Deposits or CDs	1,350	4,300	5,650
■ Fixed-income securities	–	19,139	19,139
■ Loans, senior	11,879	–	11,879
■ Loans, subordinated	2,950	–	2,950
■ Equity, public & private	1,000	9,000	10,000
Total	17,179	32,439	49,618

“We recognize, of course, that this remains a work in progress. The results are interesting, even promising, but are far from conclusive. The approach is not without risk.”

however, by the Foundation’s decision to use index products for its core holdings in its traditional investment portfolio. This has allowed us to manage our total investment expenses (traditional and mission) to 38 basis points, without discernible impact on investment returns, and freed our Board and investment staff to spend more time evaluating how effectively our program and investment activities complement our mission.

With the various changes noted, it is worth emphasizing what has not changed. We have not relaxed in any way our responsibilities as fiduciaries and stewards of the Foundation’s assets and we have not changed the Foundation’s asset allocation. Indeed, at 65% equity, 25% fixed-income and 10% alternative assets, the Foundation’s underlying asset allocation, including mission-related investments, is indistinguishable from many of its peers. Moreover, the Foundation’s total return of 21.07% in 2003 placed it at or above the median for foundations and endowments in several recognized investment surveys.

WHAT’S NEXT?

We recognize, of course, that this remains a work in progress. The results are interesting, even promising, but are far from conclusive. The approach is not without risk. But if taking well-considered risks for public benefit is not the role of philanthropy, then what is?

Over the next few years, the Foundation’s Board and staff will focus on the following mission-related investing initiatives:

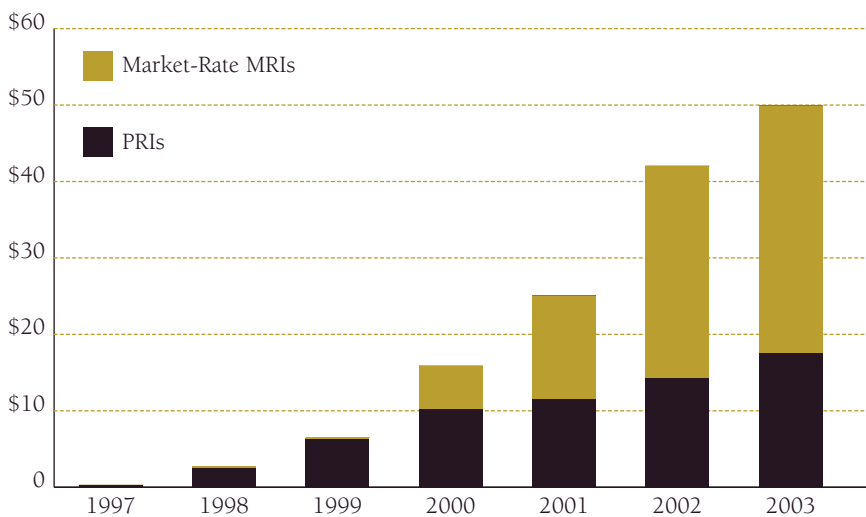
- ▶ Increasing the proportion of our endowment that is invested for mission, consistent with the availability of solid opportunities;
- ▶ Partnering with others to develop new products, such as mission-related funds of funds and positively-screened public equity products, that increase investment diversification;
- ▶ Growing the universe of institutional investors, including foundations, that make mission-related investments; and

- ▶ Working to increase the reliability and use of impact measurement systems that can demonstrate how effectively philanthropic dollars are used for community development.

In this and in other respects, we look forward to deepening our engagement with our colleagues in philanthropy, in investment services, and in community development. Only together can our resources and ideas provide truly sustainable solutions to the challenges we face.

Luther M. Ragin, Jr.
Vice President, Investments

Growth in Mission-Related Investment Portfolio, 1997-2003 (dollars in millions)



**Community Loan Fund
of New Jersey, Inc. (CLFNJ)**

Trenton, New Jersey

This community development financial institution finances viable, community-based projects in New Jersey's underserved communities. CLFNJ raises funds through the issuance of Promissory Notes and then lends these funds to organizations that produce affordable housing, child-care facilities (such as the one photographed here) and economic opportunities for low- and moderate-income people.



Community Reinvestment Fund, Inc. (CRF)
Minneapolis, Minnesota

CRF is a leader in bringing capital to community-development lenders through the creation of a secondary market for loans such as to small-business owners like this one in Minneapolis. He was able to relocate his bakery to a vacant building and become a building owner. A neighborhood improvement group works with the Minneapolis Community Planning and Economic Development Agency, CRF and community banks to help small business owners and community developers transform decaying properties.

Adena Ventures, LP

Athens, Ohio

Adena is America's first New Markets Venture Capital Company created to provide equity capital and technical assistance to small businesses operating in central Appalachia. Its mission is to promote sustainable and shared economic development in the region while generating financial returns for its investors. Its limited partners (photographed at the right) include regional banks, local universities, public utilities and foundations.



Community Loan Fund of New Jersey, Inc.*Trenton, New Jersey***Program-Related Investment:
Below-market Senior Loan**

The Community Loan Fund of New Jersey, a non-profit community development financial institution, makes loans for pre-development, construction, renovation or “gap” financing for child care centers and family-based child care providers in New Jersey. Over the next ten years, it expects to lend more than \$20 million to support 2,500 new child care openings. Already it has provided technical assistance and training to 112 centers serving 7,500 children through its “Building Stronger Centers” program. More than 80% of the centers assisted by the Community Loan Fund are located in low-income neighborhoods and serve children from low-income families. A number of centers are accredited by the National Association for the Education of Younger Children (NAEYC) or are seeking such accreditation. The F.B. Heron Foundation provides a \$500,000 eight-year loan at an average interest rate of 3% to support the Community Loan Fund’s loan program, as well as a general operating grant of \$75,000.

For more information:
www.njclf.com

Community Reinvestment Fund, Inc.*Minneapolis, Minnesota***Program-Related Investment:
Below-market Subordinated Loan**

Over the past 15 years, the Community Reinvestment Fund has worked to increase the flow of capital to underserved communities by creating a robust secondary market for community development loans. It has purchased more than \$300 million in economic development and affordable housing loans from 96 public, tribal and nonprofit groups and packaged and pledged those loans as collateral for 16 separate private placements that are sold to institutional investors at market rates of return. The groups, in turn, commit to reinvest the proceeds for community development purposes. Cumulative loan losses to date are a remarkably low 0.19%. The F.B. Heron Foundation has provided a \$500,000 five-year loan and a \$1,500,000 short-term subordinated bridge loan to the Community Reinvestment Fund at interest rates of 4% and 3.5%, respectively, to facilitate the purchase, warehousing and credit enhancement of loans. The Foundation also has provided grant support of \$100,000 in 2003 to strengthen Community Reinvestment Fund’s reserves and thus its capacity to securitize assets.

For more information:
www.crfusa.com

Adena Ventures, LP*Athens, Ohio***Program-Related Investment:
Limited Partnership Interests**

Adena Ventures, one of six New Markets Venture Capital Companies licensed by the US Small Business Administration, is a community development venture capital fund targeting the central Appalachian region. The region encompasses 4.1 million people in the 105 counties of southern and eastern Ohio, West Virginia, northeastern Kentucky and western Maryland. It contains two urban empowerment zones/enterprise communities and eight rural empowerment zones/enterprise communities. Nearly one-half of the population is low- to moderate-income. Adena seeks to increase the supply of equity and near-equity capital in the region in order to attract and retain businesses and to increase employment opportunities for residents. To date it has invested in three West Virginia and one Ohio company and has provided technical assistance valued at \$1.5 million to 29 other companies. The F.B. Heron Foundation has purchased a \$350,000 limited partnership interest with a term of ten years in this \$34 million fund.

For more information:
www.adenaventures.com

Latino Community Credit Union
Cooperativa Comunitaria Latina de Crédito
 Durham, North Carolina

Market Rate Investment:
Insured and Uninsured Deposit



Chartered in 2000 to serve the needs of North Carolina's growing Latino immigrant community, Latino Community Credit Union has grown to more than 11,000 members with \$13 million in assets. The credit union's bilingual staff provides financial literacy training to members and offers a range of credit and savings products including Individual Development Accounts and home mortgages. Last year, its members wired \$1.01 million in remittances to families in Central and South America, making Latino a leader among credit unions in overseas remittances. As a designated "low-income credit union," Latino is permitted to accept federally insured "non-member" deposits to further its work. Since 2003, the EB. Heron Foundation has maintained a \$100,000 insured deposit with the credit union at a market rate of interest. The Foundation's total portfolio of insured and uninsured deposits stands at \$4,450,000 in 40 community development credit unions and community development banks in 22 states and the District of Columbia.

For more information:
www.cooperativalatina.org

Habitat for Humanity
International, Inc.
 Americus, Georgia

Market Rate Investment:
Fixed-Income Securities (Bonds)



"Linda Mae" Bonds,
 Series 2001-1, 2002-1 and 2003-1
 Coupon: 5.0%
 Rating: Not Rated

Issued by the leading non-profit developer of self-help housing for low-income and very low-income families, these bonds helped Habitat raise more than \$43 million for its affiliates around the country. Although "Linda Mae" Bonds are not rated, they are collateralized with qualified mortgages held by Habitat affiliates whose value is nearly three times the amount of the bonds issued. Since 1976, Habitat has built more than 30,000 affordable homes in the United States and more than 150,000 worldwide. To date, the EB. Heron Foundation has purchased "Linda Mae" bonds with an aggregate value of \$750,000 with various maturities through April 10, 2011.

For more information:
www.habitat.org

Redevelopment Authority of the
City of Philadelphia
 Philadelphia, Pennsylvania

Market Rate Investment:
Fixed-Income Securities (Bonds)



Taxable Revenue Bonds, Series 2002B
 Coupon: 5.30%
 Rating: AAA/Aaa
 Credit Support: FGIC

The Redevelopment Authority issued bonds in 2002 to facilitate the redevelopment of blighted areas within the City of Philadelphia. Part of the *City of Philadelphia Neighborhood Transformation Initiative*, a public-private partnership, these "Blight Bonds" fund neighborhood planning, blight elimination and prevention, environmental remediation and land assembly for development. They also provide financial assistance for the acquisition, improvement or redevelopment of property for industrial, commercial and residential use. To date, the EB. Heron Foundation has purchased \$1,250,000 in non-callable bonds with a final maturity of April 15, 2007.

For more information:
www.phila.gov/nti



Latino Community Credit Union (LCCU)
Cooperativa Comunitaria Latina de Crédito
 Durham, North Carolina

This member-owned community development credit union is one of the fastest growing and innovative in the nation. Based in Durham, North Carolina, LCCU is the first fully bilingual financial institution in the state. Its members (such as those pictured here) can wire remittances to their families in their home countries at a cost much lower than that charged at some money-transfer agencies. Like many low-income designated credit unions, it accepts federally insured “non-member” deposits from foundations, financial institutions and other organizations.

Habitat for Humanity International, Inc. (HFHI)

Americus, Georgia

HFHI works to eliminate poverty housing and homelessness through volunteer labor and donations. Habitat homeowners invest hundreds of hours of their own labor—sweat equity—into building their house and the houses of others. Habitat houses are sold to partner families at no profit, financed with affordable, no-interest loans. This family is one of more than 30,000 in the U.S. that have become Habitat homeowners.



Redevelopment Authority (RDA) of the City of Philadelphia

Philadelphia, Pennsylvania

RDA facilitates the development of underutilized property in Philadelphia with emphasis on affordable housing and economic development. The multi-phase home-ownership project photographed here brings affordable housing to first-time home buyers with incomes at or below 80% of area median income.

Bay Area Smart Growth Fund I, LLC
San Francisco, California

**Market-Rate Private Equity:
Limited Liability Company Interests**



The Bay Area Smart Growth Fund is a \$65 million private equity fund formed in 2001 to invest in commercial and residential real estate projects in 46 low- and moderate-income neighborhoods in the nine-county “Bay Area” of Northern California. Sponsored by the Bay Area Council in association with the Bay Area Alliance for Sustainable Development and the Community Capital Investment Initiative—the region’s pre-eminent umbrella group of business organizations, community groups and municipal authorities—the Fund is managed by Pacific Coast Capital Partners, LLC a private real estate firm with considerable experience in California. It seeks a net internal rate of return to limited partners of 12% - 15%. To date, it has invested \$32.6MM (or 50% of its capital) in several projects including the redevelopment of 14.2 acres of the Oakland Airport industrial corridor, the acquisition and rehabilitation of 100 single-family homes in Alameda and Contra Costa counties for low- and moderate-income residents, infill housing development in the City of Richmond, and the acquisition and redevelopment of a 182,000 square foot community shopping center in Marin City. The FB. Heron Foundation committed \$1,500,000 in 2003 as a non-managing investor in this ten-year fund.

For more information:
www.basgf.com

UrbanAmerica, LP
New York, New York

**Market-Rate Private Equity:
Limited Partnership Interests**



UrbanAmerica is a private equity real estate fund seeking income from, and capital appreciation through, commercial real estate investments in low- and moderate-income communities in the United States. It acquires and develops commercial properties in inner-city communities and provides opportunities for corporate, government and retail tenants to locate facilities in these neighborhoods, increasing each property’s value and improving consumer choices and services for neighborhood residents. The Fund is on track to provide net returns to limited partners in the low- to mid-teens. To date, UrbanAmerica has invested \$114MM of equity and an additional \$200MM in debt in a portfolio of 28 shopping centers and office buildings in Detroit, Atlanta, Kansas City, Washington, DC, Philadelphia and several Florida cities. It frequently works in partnership with community-based organizations that know and understand local markets and have relationships with community leaders. Approximately one-quarter of its properties involved community development corporations (CDCs), with UrbanAmerica often serving as the equity “take out” buyer for projects initiated by the CDCs. This in turn creates liquidity for the CDCs that can be reinvested in new community projects. UrbanAmerica directs at least 50% of its contracts for management, security and landscaping services to community-based and minority-owned businesses. More than 1,500 jobs have been created or retained as a direct result of its investments. The FB. Heron Foundation committed \$1,500,000 in 2000 in limited partnership interests for a ten-year term in the Fund.

For more information:
www.urbanamerica.com

Yucaipa Corporate Initiatives Fund I, LP
Los Angeles, California

**Market-Rate Private Equity:
Limited Partnership Interests**



Yucaipa Corporate Initiatives Fund is a \$577 million private equity fund managed by The Yucaipa Companies LLC of Los Angeles, CA to invest in corporate partnerships that locate in, relocate to or expand their operations in underserved rural and urban communities throughout the United States. It also invests in businesses that are owned and/or managed by minorities or women. Its investors include three of the nation’s largest public pension funds: California Public Employees’ Retirement System, New York State Common Retirement Fund and California State Teachers’ Retirement System. The Fund seeks a net internal rate of return to limited partners of 25% or 2.5x invested capital. Since its close in 2003, it has made two significant investments. It purchased from bankruptcy the 60-year-old Southern home-style restaurant chain Picadilly Cafeterias, Inc, preserving 6,100 jobs in 15 states. Approximately 65% of Picadilly’s employees are minorities and 74% of the restaurants are located in underserved communities. A second investment in Christian Casey, LLC, a minority-owned firm, positions the popular Sean John clothing line for expansion with a new warehouse and distribution facility sited in an underserved community in the Northeast. The FB. Heron Foundation committed \$2,500,000 in 2003 in limited partnership interests of the Fund.

For more information:
Contact: info@ycifund.com

Photography

Front cover (clockwise from the top):

Courtesy of Jacobs Center for Nonprofit Innovation;

Courtesy of The Sheltering Arms;

Courtesy of Adena Ventures, LP;

Courtesy of Latino Community Credit Union;

Kim MacDonald, courtesy of Habitat for Humanity International.

Page 4:

(top) Courtesy of Community Loan Fund of New Jersey, Inc.;

(middle) Courtesy of Jonathan Chapman Photography;

(bottom) Courtesy of Adena Ventures, LP.

Page 7:

(top) Courtesy of Latino Community Credit Union;

(middle) Courtesy of Habitat for Humanity International, Inc.;

(bottom) Photo by Tiger Productions, courtesy of Philadelphia Office of Housing and Neighborhood Preservation.

Design

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