THE F.B. HERON FOUNDATION

A Private Community Investment Trust

We seek to shape

an endowment-investment strategy

that invests as much as is possible

in mission-related, market-rate

opportunities that deliver social

and financial returns

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Putting the Endowment to Work for Mission

For the past several years, the F. B. Heron Foundation has been working to deploy the Foundation's endowment—in addition to our charitable distributions—in direct support of the mission of "helping people and communities to help themselves." We seek to shape an endowment-investment strategy that invests as much as is possible in mission-related, market-rate opportunities that deliver social and financial returns.

Established in 1992, the Foundation's mission is to help people and communi-ties to help themselves.

Our journey has been deliberate as we have much to test and learn. As many colleagues within the grantmaking, nonprofit and private sector communities are asking us the "why, what, and how" about our approach, I decided to take this opportunity to respond. In some ways it feels premature, because there are so many questions we continue to ask ourselves. I offer this with the hope that it will contribute to the emerging dialogue on the expanded use of foundation assets. In describing this journey, I focus on several key elements:

§ the importance of a clear mission and vision as an essential touchstone

§ the need to maintain a strong connection to the communities that we serve to make sure that their concerns are addressed

§ a strong alignment between board and staff to facilitate decision making

§ the dual role of "return" as the positive impact on the lives of people and as healthy financial returns

§ a continuum of investment "tools" that best meet the increasingly sophisticated demands of the community and economic development field.

Low Income Investment Fund (formerly Low Income Housing Fund), Oakland, CA: Heron's general support grant and nine-year senior loan help to increase access to capital for community development strategies that include home ownership and quality child care, such as provided by the South of Market Childcare shown on the front cover.

WHY: MISSION AND VISION

Established in 1992, the Foundation's mission is to help people and communities to help themselves. In 2001, the board and staff refined the program guidelines to realize that mission. These guidelines identify and articulate the following five elements of wealth-creation strategies for low-income people and communities:

§ home ownership,

§ enterprise development,

§ quality and affordable child care

§ access to capital, and

§ comprehensive community development.

During this same period, the board and staff have shaped a vision: the Foundation will use the endowment to support actively and directly our mission. This straightforward notion is based on the simple recognition that all of the Foundation's assets exist to serve a charitable purpose.

WHAT: PRIVATE COMMUNITY INVESTMENT TRUST

As we started down this path, Heron's board developed a concept of the Foundation as a "private community investment trust"—a fund actively using as many of its assets as can be prudently invested for community and economic development.

The "private community investment trust" is an evolving concept and not a legal entity. Heron remains a private foundation according to all pertinent tax laws, and complies with all commensurate rules and regulations, including fiduciary responsibilities for market-rate investments. Our efforts to date have not focused on building a formal structure but, rather, on devising a means for changing the way we think and operate as a foundation. In the long term, we envision building an institution that mixes mission-related, market-rate and below-market rate investments, fixed-income and equity that, on a portfolio basis, can produce healthy financial returns. In addition, however, more resources are being focused on delivering social returns through the work of both grantees and investees.

At the heart of the private community investment trust is social return. We understand that the only true measure of this work is the success of our grantees and investees in producing results—actually helping people and communities to help themselves. We also recognize that methodologies and metrics for social-return measurement are far from perfect. However, there has been progress in defining and measuring community development "outputs" (homes built for ownership, profitability of and jobs created by businesses, accredited child-care slots, among others). Improving the field's ability to understand and express social return should serve as a catalyst to turn the concept of Heron as a private community investment trust into a reality.

HOW: AN INVESTMENT CONTINUUM THAT BRIDGES PROGRAM AND INVESTING

Heron's investment continuum covers a range of tools available to address community and economic development issues—from grantmaking to below-market and market-rate debt and equity investments. By investing across this continuum, there are multiple opportunities for impact.

GRANTMAKING

Strong connections to communities ground us in what works and what does not in community development. Our grantmaking helps us to maintain that perspective as we learn from community leaders about effective means of advancing wealth creation in low-income communities.

One way we forge strong connections with community-based groups is by supporting organizations with general support grantmaking. In 2001, general support represented approximately 75% of our grantmaking. We continue to learn from the community organizations with whom we work how valuable—and scarce—general support dollars are. These dollars help them to leverage their program efforts, to conduct "research and development" that ensure their products are responsive to community needs, to strengthen management, to develop systems to track impact and to serve as working capital.

In addition to making strong community connections and advancing issues, our grantmaking supports our investment program by enabling us to get to know an organization and identify program-related investment opportunities.

PROGRAM-RELATED INVESTMENTS

Program-related investments (PRIs) are debt or equity and equity-type investments made for charitable purposes on concessionary (below-market) terms and are considered charitable distributions by the IRS. Heron made its first PRI in late 1997. At the end of 2001, our active portfolio stood at $11.45 million, representing 30 different investments. The overwhelming majority of PRIs have been loans made to existing grantees, building upon relationships and knowledge of the effectiveness of their work.

INSURED DEPOSITS

Heron has made market-rate insured deposits in 31 community development credit unions and community development banks across the country. By the end of 2001, the Foundation had deposited $3.1 million. Terms range from one to three years at prevailing market rates. Potential deposits are screened for fit with our program areas, market returns, and soundness of the depository institution. Within an overall maximum set by our board, these simple, straightforward investments move much-needed capital to low-income people and communities.

MARKET-RATE DEBT AND EQUITY

Market-rate debt and equity investments offer a "double-bottom line" of risk-adjusted market-rate return as well as a social return. Although identifying appropriate investments with a "double-bottom line" has been challenging, by the end of 2001, Heron's portfolio in this area consisted of over $10.5 million in four separate transactions—a commercial real estate fund that focuses on inner-city retail and office properties; a later-stage private equity fund for enterprises sited in inner-city communities; a mixed-use commercial real estate fund targeting low- and moderate-income neighborhoods in the San Francisco Bay Area; and a separate fixed-income

At the heart of the private community investment trust is social return.

account that invests in investment grade, publicly traded securities that are consistent with our mission.

WHAT WE ARE LEARNING

Heron grantmaking remains an essential tool to support our investment efforts by allowing us to encourage new approaches, build networks, and support early, higher-risk stage applications of capital market techniques to community-based initiatives. The long-term relationships that we develop with high-performing grantees contribute substantially to what we are learning.

> Strong connections to communities ground us in what works and what does not in community development. Our grantmaking helps us to maintain that perspective.

There is an increasing demand by community and economic development organizations for a diversity in investments—e.g., a highly subordinated loan that a nonprofit can use as "equity" to leverage additional investment dollars.

Opportunities are growing for market-rate investment deals that align with our programs and deliver a social return. However, the requirements of a direct program fit, a serious investment discipline, and demonstrable social impact have meant that a small percentage of the deals reviewed result in investments.

It is often difficult to find partners within the foundation community because of the "wall" between finance and program. We found early partners more readily among our colleagues within financial institutions and pension funds.

MOVING FORWARD

We are determined to keep our focus on why we are pursuing the idea of a private community investment trust. The true measure of our work will be our ability to deliver returns—financial and social—that support the mission. We consider this as a model—not a definitive blueprint—but one that maximizes the best use of all our resources. We wish to emphasize that we offer this look at our early efforts at Heron with the clear understanding that we have much to learn.

There are many issues and questions requiring further analysis, review and discussion, among them:

§ What kind of road map is needed to get the Foundation substantially or fully invested in mission—and what might the destination look like?

§ What kind of technical and specialized resources will we—and similar investors—need to assure quality underwriting, competent monitoring, and performance assessment for both financial and social returns?

§ What will it mean to prepare the Foundation's board and staff to engage in this approach?

§ How can we encourage other institutions to become partners in investments?

Heron staff has worked closely with the board in implementing a careful rollout—examining the investment portfolio mix, the changing market, grantmaking opportunities, and staffing and administrative costs. Our goal is to proceed with deliberate speed and caution in order to be poised to take advantage of opportunities while not assuming unnecessary risks.

It is my hope that these remarks will encourage additional dialogue, questions, critique, and ideas on how we and other foundations might apply more resources toward our respective missions.

We invite you to join us in the discourse and the journey.

Sharon B. King

Sharon B. King
President

East Bay Asian Local Development Corporation

Swan's Marketplace—now home to over 39 families, the Museum of Children's Art, art galleries, other arts-related businesses, retail shops, restaurants, the historic Old Housewives Fresh Foods Market, and offices—was nearly torn down. This graceful old building, situated in the heart of downtown Oakland, now reflects and includes the best of Oakland because of a concerted effort led by **The East Bay Asian Local Development Corporation (EBALDC)**. This four-year-in-the-making project supports small local and minority business owners who were being forced out of their previous places of business, provides full-time jobs for over 75 neighborhood residents, and reunites communities that were physically isolated and divided by freeway construction and a new convention center.

EBALDC, whose first project converted a run-down warehouse into a community facility, used every community development tool in the book and relied on the support of community residents, funders and housing advocates to realize the new Swan's Market renovation. "We did a capital campaign, used historic tax credits and housing tax credits, and raised money from individual donors. It was a labor of love," says EBALDC Executive Director and James A. Johnson Community Fellow Lynette Jung Lee.

Lee describes comprehensive community development as "a slow building process, one that doesn't always let you see immediate results." One of the challenges that Lee and her 75-person staff face is rising land costs and increased competition with private developers and even other nonprofits for site acquisition. In 2000 EBALDC and its nonprofit partner, Oakland Community Housing, Inc., completed a 71-unit homeownership development across the street from the Jack London Gateway, a West Oakland shopping center that EBALDC is also developing. Although EBALDC continues its focus on Oakland communities, it is moving out to work in the nearby cities of Richmond, San Pablo and Alameda where land acquisition costs are still relatively affordable.

A strong believer in the collaborative process, EBALDC is also working with a group of 23 partners to promote homeownership and small business ownership by creating Individual Development Accounts (IDAs). IDAs are special savings accounts in which individuals' savings for down payments to purchase their own homes or other investments are matched at least dollar for dollar by public and private institutions. A Bay Area-wide collaborative has set up IDAs for 450 families so far. Through a HOPE VI grant, EBALDC will be using IDAS to help Section 8 tenants who live in Oakland Housing Authority units move into homeownership.

EBALDC sees tremendous opportunities for making connections with area residents and the many programs and activities that it carries out. According to Lee, "Community development can be an integrative system for helping people to take control of their lives. What's challenging and exciting are the amazing effects that can be created."

East Bay Asian Local Development Corporation (EBALDC), Oakland, CA: Heron works with partners over the long term, e.g., providing a seven-year senior loan to EBALDC to finance the development of commercial real estate to create and preserve jobs.

ORGANIZATION MISSION:
To improve the quality of life for the East Bay, particularly low-income residents and Asian/Pacific Islander populations, through development of physical, human and economic assets.

TYPE OF ORGANIZATION:
Community development corporation.

GEOGRAPHIC SCOPE:
Three neighborhoods in Oakland, CA.

POPULATION SERVED:
45,000 Oakland residents; 2,275 directly served; 39% Asian & Pacific Islander, 39% African American; 9% Latino/a, 8% European American.

YEAR FOUNDED:
1975

PRIMARY ACTIVITIES:
Affordable housing and mixed use development, including commercial real estate; property management; community organizing and planning.

CEO:
Lynette Jung Lee

STAFF SIZE:
75 FTE

ANNUAL BUDGET:
$2.7 MM operating

CURRENT HERON SUPPORT:
$75,000 general support grant; $400,000 program related investment.

Community development can be an integrative system for helping people to take control of their lives. What's challenging and exciting are the amazing effects that can be created.

Enterprise Corporation of the Delta

ORGANIZATION MISSION:
To improve the quality of life for low- and moderate-income residents of the Delta regions of Arkansas, Louisiana and Mississippi by providing financing, technical assistance, and training for businesses, entrepreneurs, home-buyers, and communities; and forging strategic partnerships that build the region's human and economic assets.

TYPE OF ORGANIZATION:
Community development financial institution.

GEOGRAPHIC SCOPE:
Delta regions (587 counties/parishes) of Arkansas, Louisiana, and Mississippi.

POPULATION SERVED:
1.76 million with 21.48% living below poverty level; median household income of $16,600; African-American per capita income 60% lower than white (1990 Census).

YEAR FOUNDED:
1993

PRIMARY ACTIVITIES:
Commercial lending; technical assistance; low-income mortgage program.

CEO:
William J. Bynum

STAFF SIZE:
45 FTE

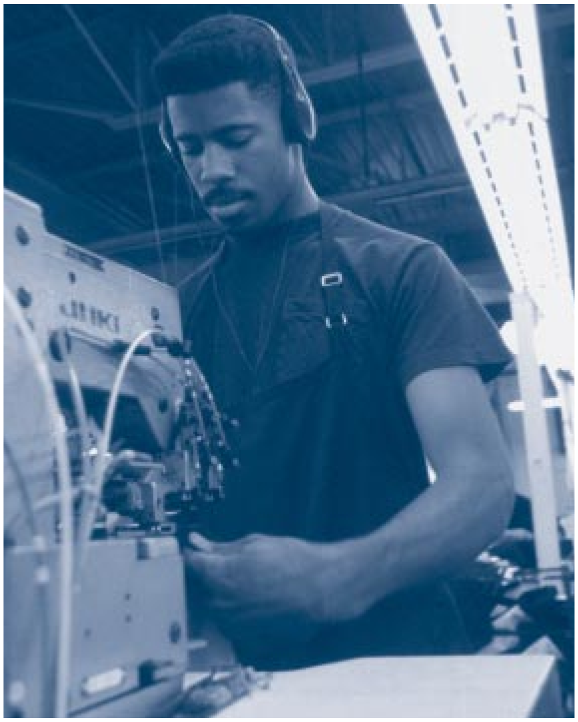
ANNUAL BUDGET:
$6.75 million

CURRENT HERON SUPPORT:
$125,000 general support grant; $250,000 program related investment.

For Delta Linen Service in Clarksdale, Mississippi, 2001 was a watershed year. After struggling through a difficult start-up period, the business finally reached "break even."

For the over forty thirty workers employed there at Delta Linen, this stability was particularly gratifying. Nearly two-thirds of the employees were previously on public assistance. After two previous managers failed, the workers were charged with handling the company's day-to-day management on an interim basis. A former line worker is now general manager.

Delta Linen accomplished this with the help of the **Enterprise Corporation of the Delta (ECD)**. Since its founding in 1994, ECD has shown what can happen when strategic investments are made in a region. "We are demonstrating what people can do if they have the tools they need," says Bill Bynum, founder and ECD's chief executive officer. "The Delta has many diamonds in the rough."



Enterprise Corporation of the Delta provides financing and technical assistance to help develop business and create and expand high-quality jobs in the Delta. Heron focuses on organizations and communities where there are strong ties between the non-profit, private and government sectors.

Bynum and his 45-person staff are using market-driven strategies to identify sectors where there are opportunities to create jobs and build a business environment to "help the Delta work." ECD has provided management and technical assistance to over 1,400 entrepreneurs in the Delta regions of Arkansas, Louisiana and Mississippi—nearly one-half of whom are women and minorities—and generated over $70 million in financing for small businesses and homeowners.

This track record laid the groundwork for ECD's management of the Emerging Markets Partnership (EMP). The EMP invests in financing and training strategies that address small business development, home ownership, child care, health care, telecommunications and workforce development. Seeded by a $20 million, five-year investment from the W.K. Kellogg Foundation, the EMP represents a long-term commitment from the Governors of Arkansas, Mississippi and Louisiana; the Kellogg Foundation; the Fannie Mae Corporation; corporations, banks and others and over 20 banks to stimulate growth and economic development throughout the Delta. The EMP is expected to generate $500 million in new investments in the region, including $180 million in small business financing that will support more than 4,000 workers and $350 million in mortgages for 5,500 low- and moderate-income residents.

ECD's history of bringing together major businesses, government, philanthropy and Delta residents puts them in a good position to carry out this exciting initiative. Their strong advocacy for increasing public and private investment in the Delta is paying off in positive impacts on people's lives. "The Delta works. ECD's job is to make sure that people have the tools that they need to be successful," said Bynum.

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UrbanAmerica, L.P.

UrbanAmerica, LP, New York, NY: Heron takes limited partnership interests to help develop commercial real estate in communities like this one in Detroit.

When most people think of Las Vegas, they likely think of its Strip, brimming with lavish resorts and 24-hour-a-day entertainment. But on the west side of town, a predominantly African American community, low-income residents lack many basics—grocery stores, gas stations, and retail services—that contribute to a thriving community. The Nucleus Community Development Corporation (Nucleus) owned a small retail/office property across the street from a vacant city-owned lot. Although active in the community for over 15 years, Nucleus lacked the technical and financial resources to develop the retail/office site, with its potential for providing badly needed retail stores and jobs in the community. By allying itself with **UrbanAmerica, L.P.**, a private real estate investment partnership, Nucleus has dramatically expanded its capacity and is jointly developing a 200,000 square foot retail center that will create new jobs and expand entrepreneurial opportunities.

UrbanAmerica is building a nationwide portfolio of urban retail and office properties. Its strategy is to provide investors with risk-adjusted, market rate returns while also creating jobs and fueling economic and redevelopment efforts, a "double bottom line." According to company President and Chief Executive Officer Richmond McCoy, "We recognized that low-income communities have a critical need for equity investments to stimulate economic development." The company has thus far raised $111 million for investment in urban communities (of which $50 million is available for investment) , creating 800 new jobs for low-income community residents in the Detroit, Atlanta, Kansas City, Washington, DC, Las Vegas, and New York City areas and in several Florida cities.

The company frequently works in partnership with community-based organizations that know and understand the local market and have relationships with community leaders. Of the 21 properties in which Urban America has invested, 25 percent have involved community development corporations (CDCs). Urban America expects that these partnerships will grow to be 50 percent of its business. For CDCs, this is an opportunity to create liquidity that can be recycled in new development projects. It's also an opportunity to change public perceptions about their work because they have real money and expertise on their side.

UrbanAmerica attracts national retailers to inner city shopping centers and office buildings, increasing each property's value and improving the choices for neighborhood residents. Local company vendor contracts for janitorial, landscaping, security and other services create local wealth. One acquisition, the Lakes Mall in Lauderdale Lakes, Florida generated approximately $196,000 in annual vendor contracts for local companies and 36 new full-time jobs for local residents.

While UrbanAmerica's investors such as the General Mills Pension Fund or LACERA may not have been attracted to the "double bottom line" that the company offers, according to McCoy, no one's unhappy about it, "This isn't something we have to do, but something that we could and should do."

We recognized that low-income communities have a critical need for equity investments to stimulate economic development.

ORGANIZATION MISSION:
UrbanAmerica, LP is a private investment fund seeking income from, and capital appreciation through, commercial real estate investments in low- and moderate-income communities in the United States. The Fund acquires and develops commercial properties in inner-city areas nationwide and provides opportunities for corporate and retail tenants to locate facilities in such communities. The Fund specializes in properties used for office, and retail, industrial and distribution purposes.

DIRECT SOCIAL BENEFITS:
UrbanAmerica has committed to serve as a "take-out" (buyer) for projects involving new commercial real estate property developed by community development corporations. In addition, the Fund directs at least 50% of its contracts for management, security and landscaping services to community-based vendors.

YEAR FOUNDED:
1999

CEO:
Richmond McCoy

TOTAL CAPITAL RAISED:
$111MM

CURRENT HERON INVESTMENT:
$1.5MM

Community Reinvestment Fund

ORGANIZATION MISSION:
To create and operate an efficient secondary market that will provide significant new capital to community-based development lending organizations by enabling them to sell their loans.

TYPE OF ORGANIZATION:
Financial intermediary

GEOGRAPHIC SCOPE:
National

POPULATION SERVED:
90 local economic development organizations that make loans in low-income communities.

YEAR FOUNDED:
1988

PRIMARY ACTIVITIES:
Purchase and securitization of community development loans; training and technical assistance to loan originators; loan servicing.

CEO:
Frank Altman

STAFF SIZE:
18 FTE

ANNUAL BUDGET:
$2.5MM

CURRENT HERON SUPPORT:
$65,000 general support grant; $500,000 program related investment; $700,000 privately placed note.

It was the late 1980s and the U.S. economy was moving into a recession, federal programs to develop communities were shrinking and there was a growing need for resources to stimulate community economic development. Without new public monies, what other ways were there to finance job creation and help neighborhoods recover, develop and thrive? An examination of market-driven solutions sparked the genesis for the **Community Reinvestment Fund (CRF)**, which provides capital and technical assistance to community development lenders through a secondary market for their loans.

"We wanted to create a market-driven organization with access to capital driven by market forces to leverage scarce resources," recalls CRF President Frank Altman. Since its inception in 1989 CRF has purchased more than 1,000 loans worth over $220 million from community development corporations and other community development lenders whose portfolios are not large enough to attract institutional investors directly.

CRF purchases economic development and affordable housing loans that are primarily made in low-income areas. The organization has created an avenue to package and resell these loans to institutional investors. The community development lenders and other public and tribal sellers must agree to reinvest new funds from the loan sales to make additional loans for community development. This new capital flowing into communities has been reinvested in small businesses, creating over 5,700 jobs, and in affordable housing, creating over 7,100 residences.

An abandoned gas station in a distressed neighborhood seemed like the perfect place to Ed Burke to locate the garden design and supply business that he had been running out of his home for 15 years. To the Minneapolis Community Development Agency (MCDA), it was an opportunity to use its development dollars to stimulate local economic activities. Burke's project was one of dozens the agency wanted to fund, but it didn't have the cash to cover all of them. So the agency worked with CRF, which put up the necessary financing to help Burke buy and rehabilitate the property. The agency has financed more than 60 properties in this way. "By working with CRF," says MCDA's Iric Nathanson, "we get really quick turnaround, we get really good service, and we don't have 100 hoops to jump through. It's just been a terrific deal for us."

CRF's growing volume of loans and the untapped potential of billions of dollars in community development loans cause Altman to believe that this is just the tip of the iceberg. "There's a lot of money out there. By freeing up dollars, we can take the pressure off organizations and get money on the street," he says. To make this happen, CRF has been very active in building the marketplace for its loans—developing tools and expertise. They have a loan-servicing affiliate for sellers and are very hands-on with community development lenders as part of their efforts to make the market more efficient.

While the future looks bright, according to the Altman, "our constraint is raising the risk capital required." Over the next two years they intend to purchase $100-150 million in economic development loans, which have generated 50 percent of their business, and $65 million in affordable housing loans.

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