COMMUNITY FOUNDATIONS X IMPACT INVESTING

THE WHAT, HOW AND WHY IT MATTERS

Parry Field Lawyers

To the heart of what matters.

Community Foundations *of Aotearoa NZ*

Hei whakakaha i ngā hāpori o Aotearoa

Prepared for

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Building*Connected*Communities
Te hanga i ngā hapori tūhono

About Parry Field Lawyers

We are one of New Zealand's leading law firms supporting purpose-led and mission focused organisations that range from charities to companies, entrepreneurs, and impact investors, as well as those with hybrid structures that combine approaches.

Our Impact Team works across the country providing free training, resources, articles, and videos to empower the 'for purpose' sector and we have around 100 staff across five offices that can support with legal set ups, charity questions, governance, property, disputes, employment, IP, and more.

Find out more at parryfield.com

Compiled by the Parry Field Lawyers Impact Team

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You need lots of different tools to get a building job done right and each have a unique role – a saw, screwdriver, drill... You wouldn't start a building project without all those things and more. They each perform a different function and it is important to have access to all of them and also understand how they work.

In the same way, Community Foundations need to utilise different tools in order to best advance their purposes. To date in New Zealand, the approach has mainly been to pool funds via donations or bequests which can then be invested in safe places with the surplus resulting used for community initiatives in the form of grants. In other words, only how profits are used is considered rather than where the capital is invested.

In this guide we outline how impact investing is one additional tool which can be used by Community Foundations to advance investment into meaningful local projects that both provide financial return and community impact.

A term we introduce here is "Community Capital" which is a way of thinking about capital that recognises both the funds, community, environment, social and other impacts that are part of the community. Capital is more than just money in a bank account, if it is used well.

If you'd like to know more about how all this might apply in your context, then feel free to reach out to us. We are one of the leading law firms for purpose-driven organisations and have a specialty in this area, and have supported many groups with all aspects of this.

Also check out our new book ***Changing Paradigms*** with 25 new essays (including a few on Community Foundations) as well as Seeds podcast which has more than 500 interviews with inspiring people at ***theseeds.nz***.

NGĀ MIHI NUI

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PART 1

FOR THOSE WHO ARE CURIOUS ABOUT WHAT THIS WAY OF INVESTING IS

So, what really is Impact Investing?

How does it relate to Business, Charities and Investors, if at all? A short explanation…

Having now interviewed over 500 guests on Seeds Podcast, a recurring theme which has emerged is how they are often using impact investing to effect positive change in our society. A question I get all the time though – both from companies, charities, directors and Trustees – is what exactly are you meaning when you keep talking about the rise of Impact Investing? Let's break it down and explain what it is and why that matters today.

The traditional approach to investing money

First, the traditional approach. Someone has a spare $10 million dollars – this is a hypothetical scenario rather than being my situation! For the purposes of this overview, let's say it is a charity which has built up those funds from donations and bequests. The Board have a choice about where they put that money. One option is a traditional approach which means they put it into a long-term bank deposit which pays interest. They get some financial return, from the interest that bank pays on the deposit, even if it is relatively low, and the offshore owned banks recycle that money to make themselves a nice profit. The Board is mainly concerned with how they use the interest returns generated by the $10 million (rather than thinking too much about where the $10 million itself is invested).

The alternative

Impact investing steps in at this point and offers another approach. The charity will have a particular cause that they care about and in fact were set up to try and solve. Unfortunately, the list is long – social housing, food deprivation and poverty, using sport to increase confidence in children, education on mental health and suicide prevention, climate change and green tech – there are many needs.

Let's choose social housing as an example of the area the charity is wanting to make a difference in. I know it well as I'm the Chair of ***Community Housing Funding Agency (CHFA)***, New Zealand's leading lender to the community and affordable housing sector (more than $550 million raised).

So, what if the charity took a portion (not necessarily all) of that $10 million and invested it into a business looking to provide social housing – it might be a start-up or a company looking to scale their social housing impact. The investment might be equity and they own shares, or it could be as debt where they loan the company money and earn interest on it.

The point is, there are more social houses built as a result of the impact investment, as well as a financial return which they can still invest (or donate) into the cause in other ways. The cause is advanced to address a problem and there is financial return from the investment itself. That is what impact investing is all about.

Maximising financial return alone is not necessarily the best thing to aim for – aligning investment so that it advances impact is.

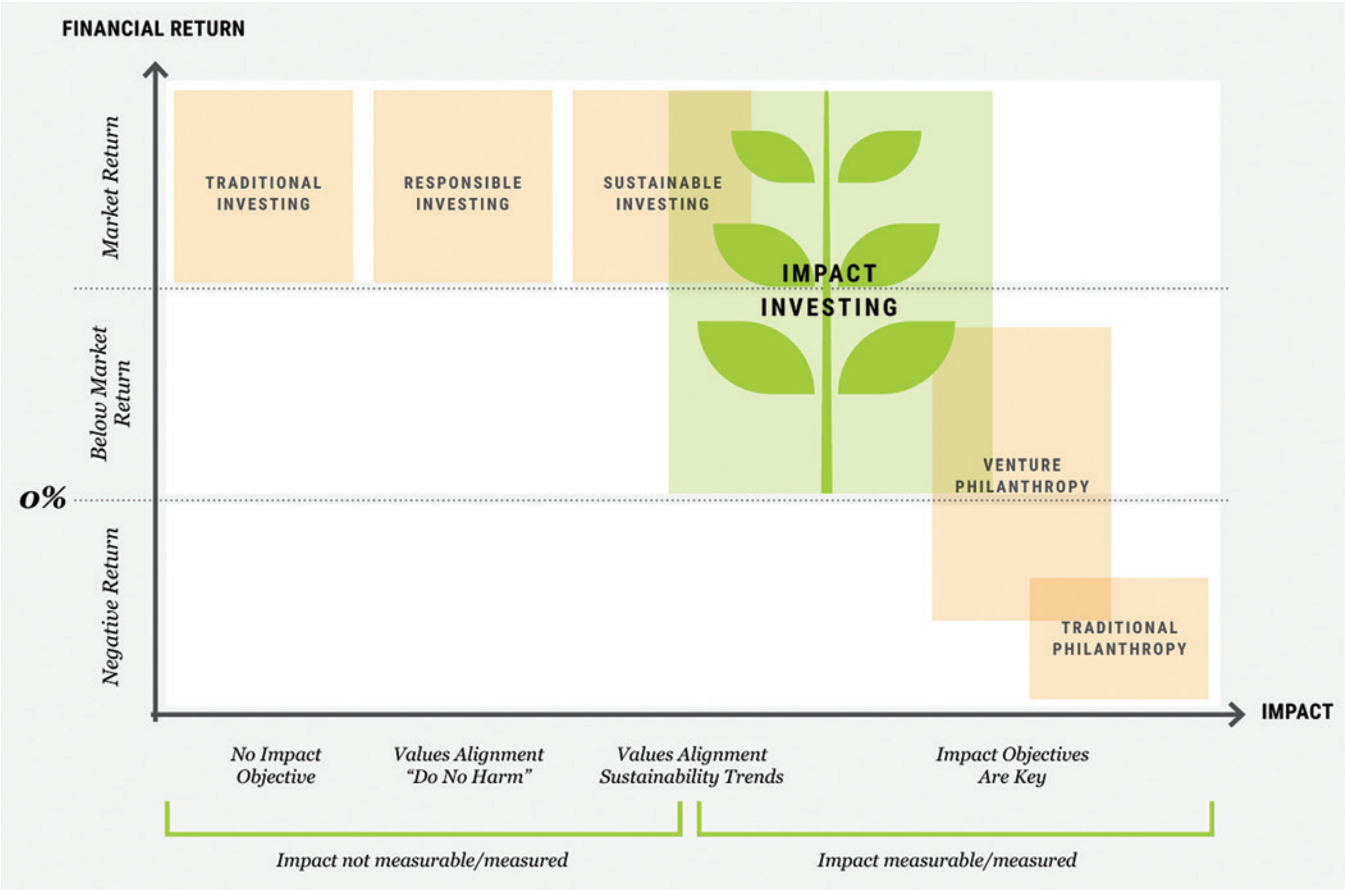


Image credit: Catalysing wealth for change: Guide to Impact Investing. Author Julia Balandina Jaquier, 2016.

In 2020, the Centre for Social Impact and Steven Moe teamed up to produce an overview of Impact Investment in Aotearoa, which includes the above image. You can read the report ***here***.

Measuring Impact

It is important to note that impact needs to be measured but it might not be in traditional measures of finance. It could be in education, climate, housing, culture, or other categories too.

Additionality

When considering where to invest, it may help to ask if you are really adding anything. Could the organisation get the same terms from a bank? If so, is there anything you are adding and should you invest elsewhere?

PART 2
FOR THOSE WHO WANT TO BECOME IMPACT INVESTORS

What might exploring this alternative mean if your Community Foundation wants to become an investor like this? The key is that it is an investment, not a donation, and it creates impact and financial return.

The crux of the difference with traditional investing is that the investor will be able to make a financial return because it is not a donation, it is an investment. But at the same time, the investor would be able to have impact which is far greater and more satisfying than the interest they make from that long term deposit.

I am not saying they need to invest the full $10 million, but if they do invest a portion of it, it is important to understand that there will be a risk/return aspect to consider, particularly if you are comparing the impact investment to standard bank deposits, however if you are managing the proportion you are investing in impact and compare that with similar traditional investment sectors (shares or fixed interest investments) it is often the ethically motivated companies that provide real solutions to our most wicked problems that will perform better, not worse, than traditional investments. A tsunami of consumer support for such initiatives is on its way as people consider the supply chain and where their products come from. Even easier than a direct investment might be joining a fund which has those ethical lenses and thinks about where they put their money – and this is a choice that each of us can easily make with our Kiwisaver providers. A real life example of this approach to impact investing is the Community Housing Funding Agency.

The Community Housing Funding Agency (CHFA) was launched with an ambitious vision – to unlock lower-cost, long-term finance for community and affordable housing providers, while offering wholesale investors a high-quality investment opportunity that delivers positive impact across Aotearoa. CHFA has advanced more than half a billion dollars in loans to sector providers, directly enabling the delivery of much-needed warm, dry and affordable homes across the country.

So, that is what impact investing is – simple, right? We may be on the cusp of going even further though.

All this fits in with a term introduced earlier – Community Capital. It is about thinking beyond just finances and looking at impact that can happen in our communities and how we can generate more community capital (not just financial capital).

Risk Management

It is important to note that if investing in startups, there will be risk. Proper due diligence, specialist advice, and beginning with a small portion allocated will all be ways to manage potential risk.

PART 3

FOR THOSE WHO ARE ON BOARDS OF TRUSTS INVESTIGATING HOW THEY SHOULD INVEST THEIR CAPITAL

Recently, we released a legal opinion on how I think Trustees of large Trusts or Community Foundations that sit on large untapped pools of wealth now have a duty to consider Impact Investing and where their funds are invested. Shamubeel Eaqub interviewed me for Seeds Podcast about that and why I think the law itself has changed. It is available at the Parry Field Lawyers ***Impact Investing Hub***.

The point is that those funds, which have billions of dollars in aggregate, often were set up by a founder or donors (such as religious groups) who wanted to tackle one of those problems in society, but the Trustees only think today about how they can use income from their traditional investments.

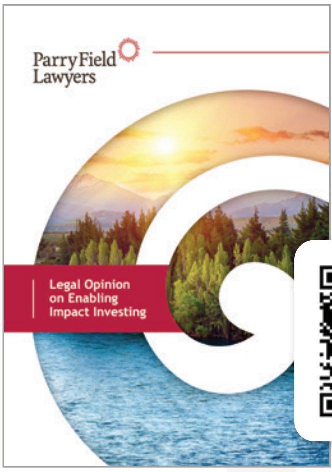
Instead, they should have a blue skies moment to think about how they invest the capital itself. Where they invest it might be a means to advance their purposes. We need Boards to be bold and consider how their capital is allocated so that it can be done with impact in mind rather than seeking out safe investments (bonds, term deposits, managed funds).

If all this is intriguing but you are wondering about the detail of how to set up the right structures and ensure your Trust Deeds and SIPOs are appropriate, then I'm happy to tell you more and also visit Boards who are on the fence at no cost, to give them an outline of how they should be rethinking this topic.

The cynical might say none of this applies to charities as it intersects with business, but I disagree. If more charities had a mindset of fulfilling their purpose first then they would see this as a massive opportunity to do even more good rather than sitting on vast reserves.

But can we do impact investing?

Aligned with this tool of impact investing, a mindset shift is going to be needed. This could involve Trustees who make the governance decisions being open to investing some of the funds they have in new ways. On this topic, many Trustees take a conservative view because they want to avoid risk and have a mistaken view of "fiduciary duty" that limits their risk appetite. We suggest reading the "Legal Opinion on Impact Investing" to better understand why we think Trustees need to think about the purpose for which they had funds endowed to them to safeguard, when deciding where it is invested (which could be in a startup that actually advances the purpose of the charity while having financial return).



What might be some practical questions to ask a Board?

For trustees you could help move this forward at your Board by asking questions such as:

- Could we use some of our capital in ways that advance our mission and have financial returns?
- How could we identify such investment opportunities, either into startups or into programmes that align with our mission?
- Could we start something and seek others to invest with us?
- Can we talk to our investment advisors and ask them about what they are investing in now, and what might be more aligned with our mission?

Now, let's turn to the practical ways that the principles outlined so far might apply to a Community Foundation.

PART 4
HOW TO CATALYSE INVESTORS TO SUPPORT A PROJECT (SOURCE OF CAPITAL)

Community Foundations could play a catalysing role in this. They often have deep connections with local philanthropists who are used to the idea of donating funds towards a project.

Instead, this approach would involve setting up a legal entity which such donors could instead invest into. A Community Foundation could play the central role in helping for this to happen.

The first example of how this occurs involves issuing of shares (an equity approach) while the second involves loans (a debt approach).

Example 1: A limited partnership with investors who own it (equity approach)

Let's say a need is identified for a Youth Hub. It will cost $10 million to build. Instead of asking for donations, a Community Foundation might:

- Create a limited partnership structure (see later for details on that).
- Approach wealthy people who are willing to invest say $1 million each (this means that they qualify as wholesale investors so do not need extensive information provided like they would if it were a retail investment for the public).
- The 10 people invest into the new legal entity and become owners of the LP.
- The new Youth Hub gets built and there are multiple income streams from:
    - Community style facilities, sports courts, room for hire
    - On the second level, a commercial space is available which is rented by youth focussed charities or other groups
    - A café is set up to provide a community connection point

This approach means that the people who put up the money get repaid the amount they invested over time as the entity is successfully run to generate some profit and have community impact.

Example 2: A company set up with loans from investors (debt approach)

An alternative to an LP structure would be for the Community Foundation to set up a wholly owned subsidiary which is in charge of the project.

Instead of issuing shares or having the people with money as investors who own part of this, they instead are asked to loan money to the company. This is done with the following in mind:

- The loans may be at a preferential interest rate (the most preferential being 0%)
- They do get paid over time – it is not a donation
- The loans are documented legally with binding agreements
- They do not qualify the investor to share in profits, only get repaid

With this model there is less ongoing involvement after the loans have been repaid, but it allows the project to get enough funding to get off the ground.

The investor gets their money back and also knows that there is great impact for the community.

As you can see, this obtaining of funds could be done though equity (the investor owns) or debt (the investor loans).

For those of you who are encouraged by this possibility, we would also add that investors will want to know the story of impact. This is about more than just financial return, so you need to tell them why your idea or venture is a good one with stories of who will be supported. Think beyond just traditional metrics for an investor and spend time on explaining the stories behind what you do and why.

Startups Legal Toolkit

For more information on startups and things they should know, view our guide ***here***.

PART 5
KEY LEGAL CONSIDERATIONS (THE BEST STRUCTURE OPTIONS)

If you are looking to explore how to structure investing then the examples before have already given some idea of options.

We come alongside to really understand the drivers and motivations of a group when they want to get into impact investing and the key legal structures that will best suit.

Think of legal entities like vehicles that get you from A to B, or B to C. There are many different types of vehicles (4x4, motorcycle, campervans) each with their own positive and negative attributes.

Here are some of the key legal structures you could consider:

Limited Partnerships

Probably best when there is a specific project in mind, this structure involves some who invest money (the limited partners) while there is a general partner who oversees and runs the project. The benefit for a Community Foundation is that you get taxed at the tax rate of the individual entity.

The way it works is shown in this diagram:

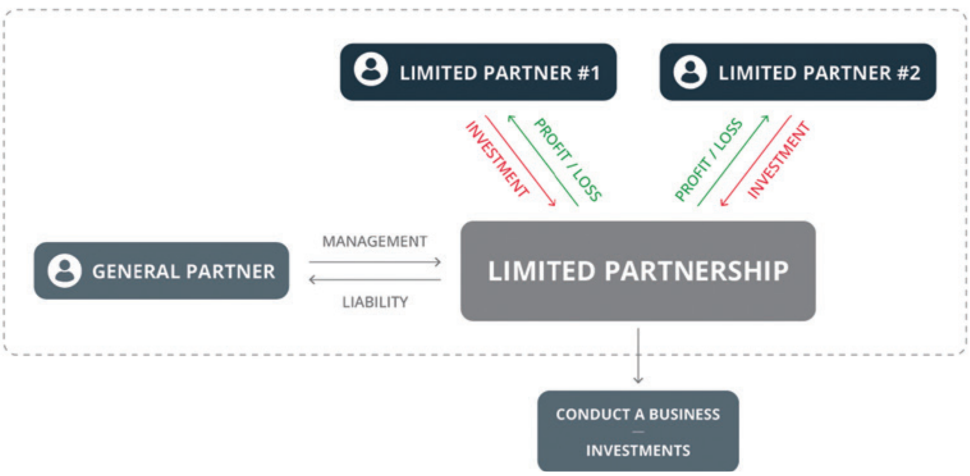
Companies

This is a well understood legal structure. The reason it can be an appropriate option is that you can issue shares in the company so that you get a stake and receive a portion of the profits as dividends. This could be useful for a Community Foundation to take a direct stake in a startup.

Charities

It might be that the legal structure options would involve charitable elements as well, for example by partnering with other charities to co-invest rather than feeling like your entity needs to make the sole investment.

Rather than put too much more on this here, would just make the offer that our team is happy to talk with you if you'd like to explore what option might be best in your context.



For more on this you can read this article: ***How can Limited Partnerships help Entrepreneurs?***

CONCLUSION

Impact investing presents an opportunity to do things differently.

It combines the financial return that an investor would want with the ability to also know that there is direct impact for people and a building up of "Community Capital" which is hard to put a financial measure on.

The way forward might involve amending your founding documents to allow for this or adopting policies that free up such investment. It might also involve some blue skies thinking to consider how you might find potential investments and what form those investments might take (loans, shares, hybrid options). If you have an idea for a project then it might involve creating a legal structure that will allow impact investors to come on board and fund your vision.

Impact investing is a way to ensure your organisation is having maximum impact – it is worth considering the way we invest and what we invest into. Let's learn from what others are already doing around the world and then take steps here to implement the concepts, in order to really become catalysts for impact in our communities.

We can do this.

ANNEX 1
A FEW CASE STUDIES

In this part we will outline a few examples, both here and overseas.

Canada

Here are a few examples from Michelle Baldwin that include community foundations in Canada and other related examples:

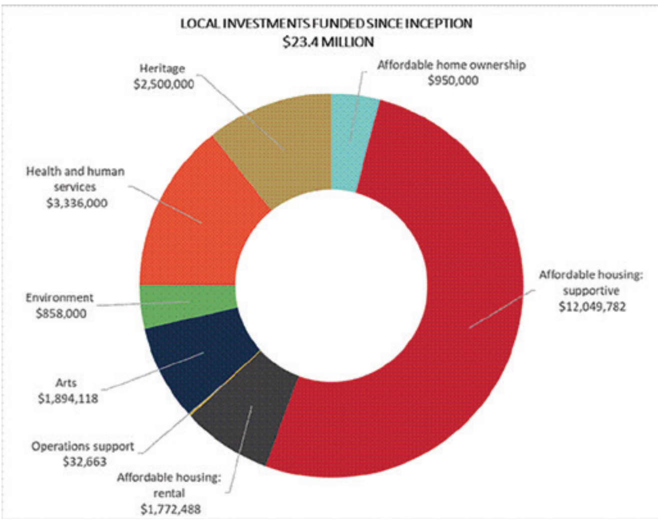
- Hamilton Community Foundation was an early leader in impact investing with total impact investment commitment at $62.9 million. They have a really good description of their approach to impact investing which explains how they consider where they put their capital. They were part of assembling community foundations and doing the due diligence for a 6.25M investment into the ***Canadian Canoe Museum***. They describe their approach like this:

  "As a public foundation, we exist to advance our mission and vision in the interest of the public good and in support of our donors' intentions. We challenge the premise that our investments are only a means to create income to fund granting and operations of the Foundation ... Recognizing that all investments have impact, we believe they can be powerful tools to accelerate achieving our vision and mission. For Hamilton Community Foundation, "all in" means we are committed to aligning 100 percent of our investments with our mission and vision through:

  Impact investments: Public and private investments intended to create positive impact beyond financial returns.

  Responsible investments: Public market investments that integrate environmental, social and governance factors (ESG) into their selection and management."

For more visit: ***hamiltoncommunityfoundation.ca/investing/*** and stories ***hamiltoncommunityfoundation.ca/impact/#investing***.



An example of what the Hamilton Community Foundation has invested in is Raven, an indigenous impact investment fund which has raised money and then invests into indigenous led enterprises receiving between $250K and $2M with those startups giving financial return and positive impact. A description of this: "The objective of the fund is to support innovative, scalable, purpose-driven Indigenous businesses to reduce poverty, create employment and improve the quality of life of Indigenous Peoples across Canada, while generating a target return of six to eight percent for investors."

Community Housing

As a social enterprise, Community Housing Funding Agency (CHFA) was able to raise capital via investment from a number of philanthropically minded organisations such as the Tindall Foundation, Lindsay Foundation, Hoku Foundation, Clare Foundation and more. It was those investments that allowed the organisation to explore a new way of funding community housing providers. This led to Government support, an A+ rating from S&P and interest from mainstream investors in this impact investing approach.

Now the total value of investments is over $500 million with the funds going into the entity and then loaned out to Community Housing Providers around the country which are building houses for those in need in their communities.

The point is that without the initial funding from the investors who believed in the idea, the CHFA's model that benefits both borrowers and investors would not have been given the chance to succeed.

Kitea Health – Soul Capital Case Study

Kitea Health is an Auckland based medical device company developing an implantable sensor that lets hydrocephalus patients and their whānau monitor shunt function from home. Soul Capital's investment in Kitea Health is structured as a minority equity stake, so the fund's return is tied directly to the company's growth. The impact thesis centres on health equity. Hydrocephalus is no more common among Māori and Pasifika communities, but outcomes are markedly worse, driven by longstanding access barriers. Kitea's technology gives whānau a way to check shunt function without an emergency department visit, reducing false alarms, easing the burden on caregivers, and handing some control back to patients navigating a health system that, historically, hasn't served them well.

Due diligence on the impact case ran alongside the usual technical, regulatory, and clinical review. The deal team examined how inclusion was embedded in Kitea's product design and team culture and named the risks plainly. Due to confidentiality, the fund won't have access to patient data, so the real-world difference the device makes must be evidenced through clinical trials and independent research. There's also no guarantee that priority communities will get equitable access once the device reaches market, given the same health system that created the inequity will be the one distributing it. The impact is tracked with named indicators and revisited as the company moves from trial phase to market.

OpenStar Technologies – Soul Capital Case Study

OpenStar Technologies is a Wellington based fusion energy company pursuing a levitated dipole design, a different approach from the conventional tokamak most competitors use. The company is years from commercial revenue, so the impact case here sits at a different level to others with more immediate impact. The primary thesis is environmental: a credible path to clean, abundant energy would change what's possible across the economy. The secondary thesis is equity. The company has built partnerships placing Māori and Pasifika students and graduates into high value technical roles in a sector where those communities remain significantly underrepresented.

The due diligence process is a useful illustration of what equity impact investing asks of an investor in deep tech. Alongside technical and commercial review, the fund carried out separate impact research to test the equity case on its own terms, drawing on site visits, IP review, and diligence already completed by an existing investor. The engineering may not succeed. The impact thesis was written to hold regardless, the country gains from the technical capability built and the doors opened for young people from underrepresented communities, whether or not the fusion technology itself reaches market.

ANNEX 2

THE ROLE OF EDUCATION: SUPPORTING GROUPS WHO CREATE THE PROJECTS (END USE FOR CAPITAL)

This is beyond the scope of this paper but potentially a role for a Community Foundation could be to support entrepreneurs in the area they operate. In particular, to encourage the entrepreneurs who are purpose driven and who have solutions that will benefit the community as well.

This support could be done in the following ways and it might be that it would result in opportunities for investment to be found.

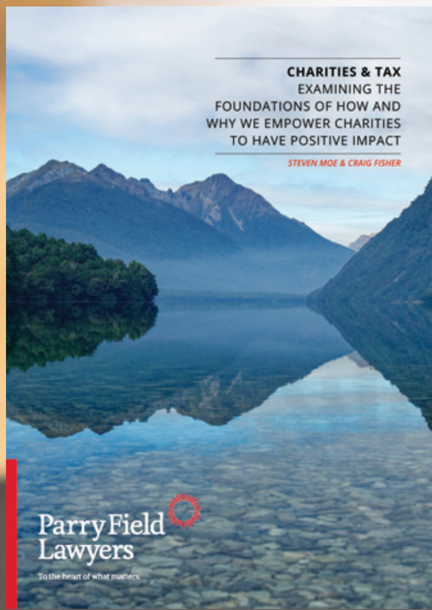
Some examples are:

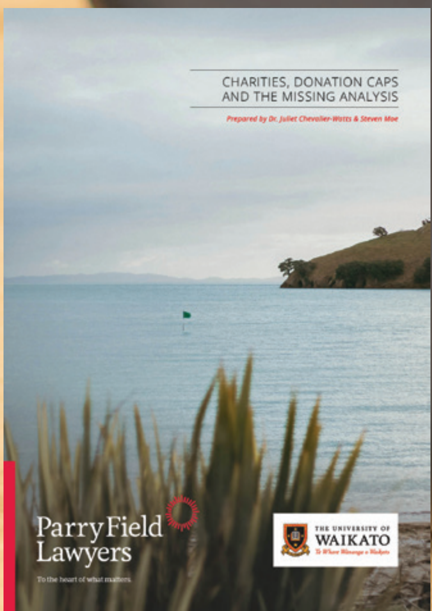
- **Education**: providing one off webinars or in-person gatherings where the Community Foundation facilitates the lessons being given from an expert on areas such as startups, financing, legal structures, purpose, marketing, measuring impact, etc.
- **Accelerators:** This could involve a programme of days or weeks where people apply to attend a course and there is training on a variety of topics that will help the startups to succeed.
- **Grants:** There could be a fund set up to support startups to meet certain criteria and then receive some funding to advance their idea by being subsidised or funding provided for something they will need to be successful.
- **Supporting existing programmes:** Many regions already have startup accelerators and programmes so it might be the Community Foundation would not need to reinvent the wheel but instead could come alongside such a group in order for them to run a programme that it funds.

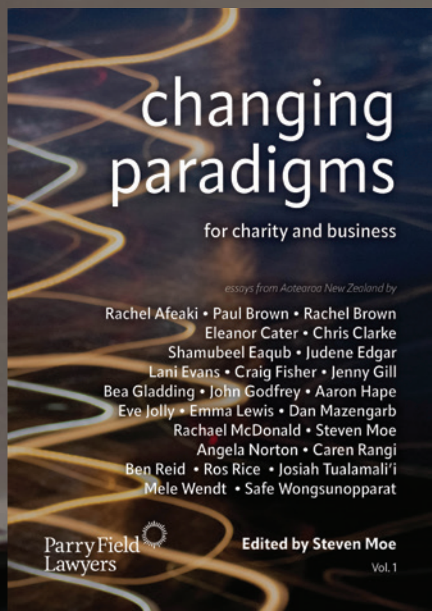
It would be possible that a condition of being part of these sorts of programmes is that the Community Foundation has an option to become an investor in the startup, so that it will have ongoing exposure to the growth of the startup.

As a personal note, I have been asked to speak at the type of education events mentioned above and I am happy to do so. In my experience, there will be startups that emerge from them who become successful, so it is a way to catalyse the impact in the region you operate.

Other free guides at parryfield.com/publications include:







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