Effective and Emerging Approaches to Mission-Related Investing

Sarah Mahlab and Brad Harrison, Canopy

Introduction: why mission-related investing?

The world does not lack capital. Everywhere you look, money is seeking return – from university endowments to wealthy individuals to institutional investors.

But does that capital always flow to the right places? Unfortunately, no – it tends to flow towards scale and security rather than where it can make the greatest impact. In pursuit of financial returns, investors often overlook the unintended consequences of their investment decisions. Without realizing it, their investments may be perpetuating many of the problems they're trying to solve separately through philanthropy. Take for example an environmental organization using profits from the fossil fuel industry to fund watershed restoration, or a foundation using funds derived from subprime lending to provide capital for under resourced communities. If investment activities and philanthropic activities remain disconnected, we may never get ahead.

This is happening for a number of reasons. Increased complexities in financial markets, high costs associated with the creation of new investment funds, lack of specialized investment research, inefficient opportunity discovery, and non-standardized analytical tools are all barriers embedded within the non-traditional investment process. Often, these strategies are absent from institutional investment platforms because they are too expensive to even consider. In short, the explicit and implicit costs throughout the investment process force investors to seek opportunities large enough to warrant the price tag. Big ventures attract big institutional investors, repeatedly leaving smaller, local opportunities behind. And, in general, our economic system does not price in all of the social and environmental costs associated with our investment activities.

Luckily, many investors are working to shift this paradigm. Foundations in particular are seeking ways to extend their investment corpus ("the other 95%") so that it aligns with their grant-making programs. For these foundations and for other institutional investors, "impact investing" or "mission related investing" (MRI) offers an opportunity to leverage an organization's full financial resources in support of its values, thus better aligning investment and philanthropic outcomes.

Although MRI has much in common with impact investing, the two are not synonymous. MRI is a strategy aimed at aligning an organization's investment portfolio with its' philanthropic mission. For example, a foundation with an environmental mission might consider divesting from fossil fuel companies as a MRI strategy. Mission-related investing is commonly associated with foundations or other mission driven organizations, and unlike impact investing, may not have an explicit emphasis on "additionality" and "measurability".

Meanwhile, impact investing is an approach to investing that seeks to generate social and environmental outcomes alongside financial returns. Impact investors are intentional about finding investments that create "additional" and "measurable" impact. Additional means that the social or environmental outcomes of an investment would not have occurred otherwise in the marketplace if the investor had not intentionally made the investment. Measurable refers to the ability to quantify and track an investment's nonfinancial returns, whether these returns are realized through the job creation, carbon sequestration, small business lending, or other such outcomes.

Like impact investing, "place-based" investing provides a new framework for making investment decisions. Place-based investing is an investment approach centered on certain geographies and local economies; it appeals to organizations focused on local or regional community development. Approaches such as impact investing and place-based investing provide investors a way to find and evaluate overlooked and values-driven investment opportunities. Still, many investors do not fully understand the full complement of impact investing strategies and how to implement them effectively.

Impact investing primer: understanding the basics

What is impact investing? In the simplest terms, impact investments are "investments into companies, organizations and funds that are intended to generate measurable social and environmental impact alongside financial returns."[1]

Impact investing is an approach to investing, not a separate or new asset class. Impact investments occur across all asset classes, including cash, fixed income assets, public equities, private equity, venture capital, private debt and real assets. Investments may focus on many sectors or impact themes, including access to capital and basic services, community development, education, energy and the environment, and health, among others. Furthermore, impact investing occurs across all geographic areas; on a local or global scale, and in either developed or developing countries. Many impact investors focus on a single asset class, geographical area, or impact theme, while others have a broader or integrated approach.

Approaches to impact investing vary by financial objectives, impact objectives and asset class. Some investors recognize a trade-off between risk, return and impact while others do not. Although the differences among the various approaches are often hard to discern, the following table categorizes the most common approaches to impact investing:

Impact Investment Spectrum

	Traditional	Socially Responsible Investing	Sustainable/ ESG Investing	Financial-first Impact Investing	Impact-first Impact Investing	Program Related Investments	Charitable (Grants)
Financial Objective	Market rate				Concessionary		
Impact Objective	None	Low	Mid		High		
Investment Screening Criteria	Financial	Financial + negative ESG	Financial + positive ESG	Financial first + impact	Impact first + financial	Impact scalability	Mission

Source: Canopy, 2015

Each of the approaches to investing identified in the table above has distinct characteristics. An investor may choose to focus on one approach exclusively, or may adopt one or more within the spectrum depending on their mission and objectives.

Socially responsible investing (SRI)

Socially responsible investing (SRI), which is most similar to traditional financial investing, traces its origins to religious groups. SRI investors apply "negative screens" to the investment opportunity set to attempt to minimize their exposures to "bad" companies or industries, such as those that produce goods that may be considered harmful to society (such as tobacco or firearms) or those that involve governments that commit human rights abuses (such as South Africa during the Apartheid era). By excluding certain

[1]Global Impact Investment Network (GIIN), "About Impact Investing," *www.thegiin.org*.

companies or governments, SRI investors seek to minimize damage done through their investments, rather than explicitly trying to promote change or encourage best practices. Moreover, the use of negative screens and divestment strategies enable SRI investors to raise public awareness, thereby putting pressure on these businesses to change their policies and practices. SRI is most commonly associated with investors in public equities.

This is a big market. According to the Forum for Sustainable and Responsible Investing, investment managers using SRI strategies were responsible for a total of $6.57 trillion in U.S.-domiciled assets in early 2014, a 76 percent increase from the $3.74 trillion total U.S.-domiciled assets under SRI management at the start of 2012. These assets comprise more than 16 percent of total dollars under professional management in the United States.[2]

Sustainable investing, or environmental, social, and governance (ESG) investing

Sustainable Investing, or Environmental, Social, and Governance (ESG) investing, takes SRI investing one step further. ESG investors use a company's environmental, social or governance (ESG) practices to evaluate their corporate social responsibility record. Through a process called "positive screening," investors identify companies with business models that promote desired outcomes. Investing in these companies may offer long-term performance advantages to investors because the company's ESG policies may be a way to mitigate business risk. Examples of common ESG factors include race and gender diversity in company leadership, responsible environmental policies, and equitable labor practices. ESG investing may also involve "shareholder engagement" strategies, whereby investors vote their proxies or encourage shareholder resolutions aimed at influencing corporate behavior. Successful ESG investors must have intimate knowledge of companies, sectors, and macroeconomic trends. Like SRI, ESG investing is most commonly associated with investments in public equities.

Impact Investing

Impact investing integrates analysis of social, environmental, and regional economic development outcomes on an even deeper level. Impact investors are acutely intentional about the social, environmental, or place-based outcomes they seek to generate through their investments. Impact investors keep these criteria in mind at each step of the investment process, from idea sourcing to investment monitoring. Impact investors also consider whether an investment is "additional", and assess the broader or unforeseen social and environmental consequences associated with the way their capital is used.

Impact investors may invest in for-profit companies that have a business model generating both profit and social and/or environmental outcomes through their product or service (think social enterprises) or in nonprofits that have revenues and earned income streams. Although they vary in their financial return expectations, it is generally accepted that impact investments will at least deliver a return of capital (principal) and potentially some level of return on capital (returns above principal). Still, there is emerging data that impact investing is actually a value-add strategy, and funds that have "impact" as a core driver of returns have actually outperformed the market.[3]

The range of impact investment approaches is suggested in Figure 1 below, which breaks down impact investments according to theme, asset class, and geographic focus. Data for this table is derived from the Global Impact Investing Network's (GIIN's) ImpactBase, a database of impact fund managers.

[2] The Forum for Sustainable and Responsible Investing, "Report on U.S. Sustainable, Responsible, and Impact Investing Trends 2014," (10th Edition, 2014).
[3] "Introducing the Impact Investing Benchmark", Cambridge Associates and Global Impact Investing Network, 2015.

Source: Global Impact Investing Network (GIIN), ImpactBase Snapshot, March 2015

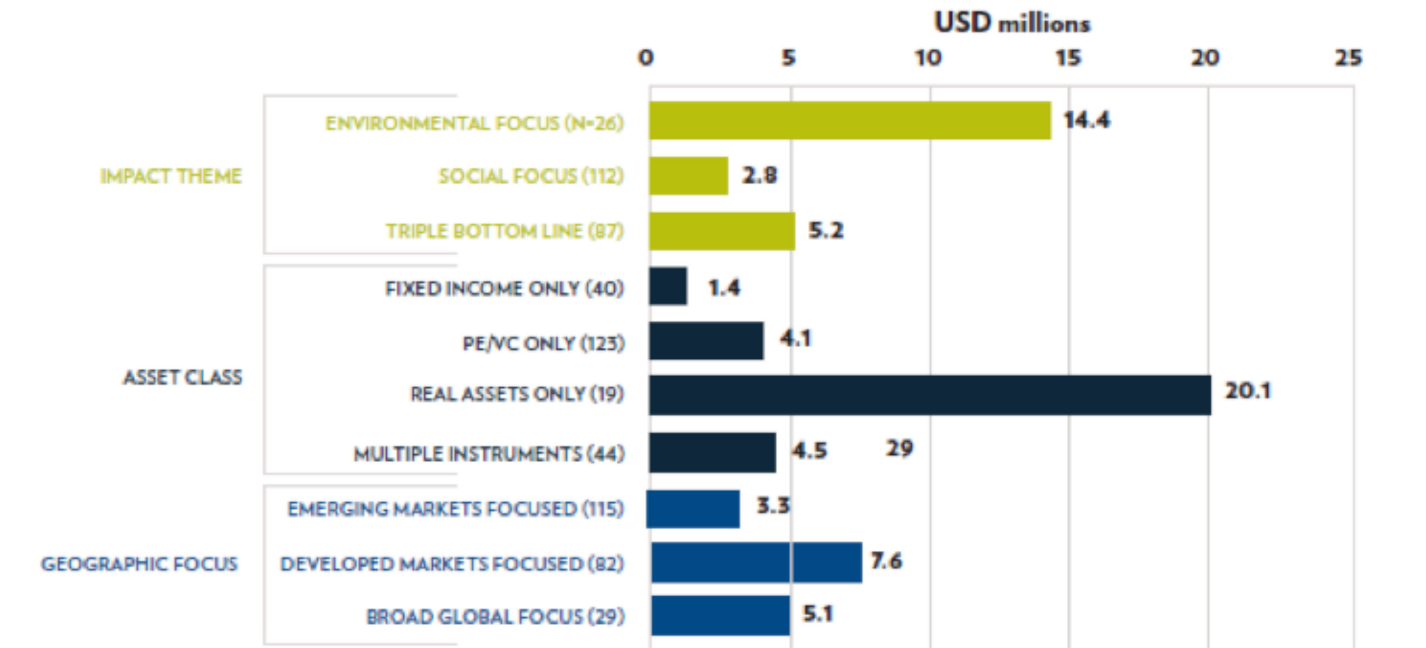


Figure 1: ImpactBase funds' average investment size by impact theme, asset class, and geographic focus

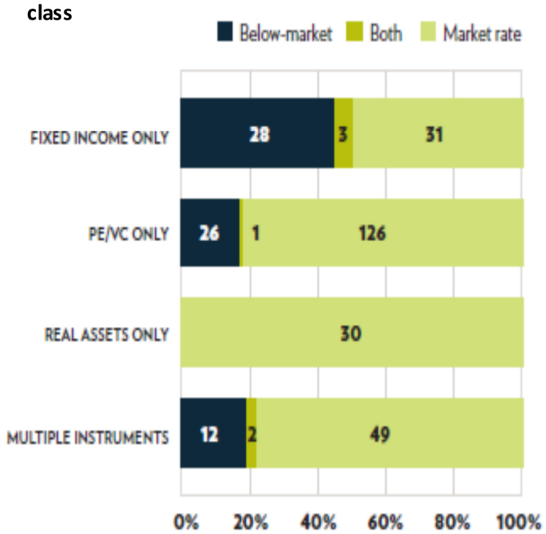
Impact investing is gaining momentum with mainstream investors. According to a 2014 report by J.P. Morgan, based on a survey of 125 impact investors, the market for impact investing in 2013 was $10.6 billion and investors anticipated a 19 percent increase in 2014.[4]

In spite of increased momentum, impact investing is not without its challenges. The first is reporting the nonfinancial outcomes of investments. Defining and tracking impact metrics requires practioners to standardize, prioritize, and measure outcomes that are difficult to quantify. While several frameworks are available, a number of industry leaders are working to improve standardization (think Generally Accepted Accounting Principles for impact investments). In the growing movement for mission-related and program-related investing, quantifying outcomes is becoming a requirement for companies to help demonstrate alignment with investors' charitable purpose. The second challenge is the cost of discovering investment opportunities (many of them small) and the cost of investment research on often complex, unique and/or niche strategies. Last, but not least, is that many of these fund managers lack a historical track record of investing.

To overcome some of these challenges, investors must evaluate trade-offs in terms of risk, reward and impact. Investors integrate a "third dimension"—financial return, social return and risk— to evaluate any potential "tradeoffs". In some cases, investors seek to optimize rather than to maximize any one of these dimensions. Often times, this may lead to investments that yield below market returns, from a financial perspective, but above market returns from a social or environmental perspective. This trade-off represents the key difference between "financial-first" impact investors, who prioritize financial returns over social or environmental outcomes and "impact-first" impact investors, who prioritize other outcomes over financial returns. As Figure 2 demonstrates, out of 310 impact investment fund managers listed on ImpactBase, the majority sought a market rate of return. Figure 3 analyzes the terms "market rate" and "below market rate" as applied to different asset classes.

[4] J.P. Morgan Global Social Finance, "Spotlight on the Market: The Impact Investor Survey" (report, J.P. Morgan and Global Impact Investing Network, 2014), *www.thegiin.org/assets/documents/pub/2014MarketSpotlight.PDF.*

Figure 2: ImpactBase funds by philosophy of return and by asset class



Source: Global Impact Investing Network (GIIN), "ImpactBase Snapshot: An Analysis of 300+ Impact Investing Funds," April 2015

Figure 3: Average target return by asset class

	MARKET RATE	BELOW-MARKET
FIXED INCOME ONLY	6.2%	2.9%
PE/VC ONLY	19.3%	5.5%
REAL ASSETS ONLY	14.9%	–
MULTIPLE INSTRUMENTS	13.9%	5.4%
OVERALL	16.2%	4.4%

Source: Global Impact Investing Network (GIIN), "ImpactBase Snapshot: An Analysis of 300+ Impact Investing Funds," April 2015

Financial-first impact investors seek investments that realize market rate risk-adjusted financial returns, as well as high levels of social impact. A growing number of investors are making the case that impact might actually provide a competitive advantage over traditional investments by finding inefficiencies within financial markets (i.e. things the market has mispriced), thus producing long-term financial out-performance. Therefore, investments that take into account social and environmental outcomes may correct the market and outperform traditional financial investments over the long term. This concept, often referred to as "returns from impact" posits that products or services with intrinsic focus on social impact provide superior performance. Nevertheless, financial-first impact investors' foremost concern is to maximize financial returns.

By contrast, impact-first impact investors are often willing to accept concessionary levels of financial return in order to yield some other social or environmental return—or they are seeking a unique optimization of two or three. To meet their desired social or environmental goals, impact-first investors may be willing to accept a below-market return, or take higher than market risk for an expected return, or stretch out their investment horizon longer for an expected return than a traditional investors. As a result, they are "blending" their returns to yield some optimal, and intentional, outcome.

Program-related investments

Program related investments (PRIs) are a statutory class of investments for private foundations, defined by the IRS.[5] Private foundations can claim PRI status for an investment as long as they meet the following conditions:

- Their primary purpose is to accomplish one or more of the foundation's exempt purposes.
- Production of income or appreciation of property is not a significant purpose.
- Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose.

In practice, these statutory conditions dictate that PRIs have an interest rate or financial return objective lower than prevailing market rates for loans and investments of similar duration, credit quality, and risk. PRIs can achieve market rates of return if investment

[5] U.S. Internal Revenue Service, "Program Related Investments," *www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Program-Related-Investments.*

duration, credit quality or risk are elevated based on expected mission outcomes. One benefit of PRIs is that the IRS considers them part of the foundation's 5 percent annual distribution.[6] Therefore, PRIs enable foundations to leverage their balance sheets and to fund more projects.

PRIs are still uncommon among foundations. According to J.P. Morgan's case study of over 100 innovative foundations with $46 billion in investments, the 2014 average proportion of PRIs to grants is 8 percent.[7] Investments in private debt are the most common type of PRI. However, as a result of the recent welcome guidance from the IRS, more investors are likely to seek PRIs in the future.

Implementing impact investments

Recognizing goals, priorities, and the feasibility of implementation is a key first step for foundation staff and their advisors seeking to apply impact investing strategies. Most foundations engage an investment consultant with expertise in impact investing at the outset, since impact investment approaches are still emerging and knowledge is highly specialized. Some foundations have chosen to approach impact investing through a portfolio carve-out and others have integrated it into their broader investment portfolio.

Although the process for implementing this investment approach may appear linear, it is important to recognize that these steps can and should be iterative. First-time impact investors will find a growing number of models for investment implementation. Even experienced impact investors are constantly evaluating their mission goals and investment outcomes, seeking to determine whether an investment is a good fit for their organization, as well as looking for new ways to invest.

Please see the attached resource guide for further information on implementation.

Impact Investing Roadmap

1. Determine your investment goals and understand risks.
2. Identify your investment criteria.
3. Evaluate opportunities and limitations across asset classes.
4. Conduct a blank slate analysis of your existing portfolio.
5. Identify investments that align with your mission.
6. Begin with asset classes with broad exposure.
7. Incorporate opportunities within all asset classes.
8. Review goals, evaluate impact, and measure performance.
9. Repeat and continuously reevaluate.

Another approach to impact: place-based investing

Investors seeking to make an impact close to home or within a specific geographical area are increasingly turning to the notion of place-based investing. Place-based investing takes many of the same concepts behind impact investing and applies a geographic lens to the opportunity set. Place-based investors may also concentrate on specific social or environmental themes, but typically prioritize geographic and/or community oriented considerations in the investment evaluation process.

Many place-based investors choose this approach to direct their capital towards a specific region. Instead of making investments in globally diversified investment funds, they put capital to work in local economies. For some investors, place-based investing might mean providing access to capital for underserved populations, supplying seed funding or venture funding for small businesses, or collaborating with government entities to invest in infrastructure projects in a specific place. For others, it might mean revitalizing certain parts of a city or improving natural resource management in a region. Investors may be focused on places as small as a watershed or as large as an entire region.

[6] Internal Revenue Service, "Program Related Investments."
[7] J.P. Morgan Global Social Finance, "The Impact Investor Survey."

Place-based investing may be especially appealing for community foundations, rural foundations, regional economic development agencies, and other organizations in which place is critical to their mission.

Like impact investing, place-based investing affords unique challenges and opportunities. Identifying and tracking regional outcomes that are meaningful and quantifiable, such as job creation and retention, is both critically important and extremely difficult for this emerging field. In addition, place-based investment managers must be skilled at coordinating, communicating, and negotiating the sometimes competing priorities of different community stakeholders. Fund managers must also find creative ways to involve capital providers, community leaders, local governments, and the people of the community in their investment solutions. We're learning that this inclusiveness and coordination must be baked into the DNA of any investment or initiative to be successful, both from a financial sustainability and regional outcome perspective.

Case study: Canopy LLC
A new model in collaborative place-based investing

Place-based investing is why three foundations in Oregon and Washington launched Canopy in early 2015. Canopy was created to fill a void that exists between institutional investors and community-based investment solutions.

Canopy is developing an investment community where foundations, corporations, government, and individual investors collaborate to identify, prioritize, and allocate investment capital where they work and live. By coordinating efforts and leveraging capital from across the Pacific Northwest, Canopy hopes to enable the region's many disconnected stakeholders to become part of a larger community-driven, purpose-built investment collaborative.

Taking its name from the tops of the great forests that still cover much of Canopy's pilot region, the Pacific Northwest, Canopy's mission is to deliver meaningful investments that address the specific needs of the region and effect change in the community. At the same time, Canopy intends to build a scalable investment model that can be replicated nationwide, so organizations around the country can put real muscle into local investing. Canopy intends to translate its work in the Pacific Northwest to meet the unique needs of other geographic areas over time.

Canopy is the first collaborative platform that is making place-based investing accessible to investors at scale. Canopy is helping investors find new ways to connect and to use capital to strengthen towns, communities, and regions.

Who is behind Canopy?

Canopy's founders are Meyer Memorial Trust, based in Portland, Oregon; The Russell Family Foundation, based in Gig Harbor, Washington; and The Laird Norton Family Foundation, based in Seattle, Washington. Meyer Memorial Trust makes grants and investments in the state of Oregon within four areas: affordable housing, education, the environment, and a vibrant nonprofit sector. The Russell Family Foundation also has a deep commitment to place, with its programs focused on the Puget Sound region, with a particular emphasis on the south Puget Sound and Pierce County. The foundation's activities focus primarily on grassroots leaders, environmental sustainability, and peace. The Russell Family Foundation's most recent initiative centers specifically on the Puyallup River Watershed in Washington. The Laird Norton Family Foundation – equally committed to place-based investing – supports arts in education, climate-change mitigation and adaptation, and watershed stewardship.

Canopy was incubated at Threshold Group, a wealth management firm based in Seattle, created by the Russell family in 1999 upon the sale of Russell Investments to Northwestern Mutual. The Russell firm, commonly recognized for its stock indices, built its core competency through decades of fiercely independent evaluation of investment managers. Building off the Russell families legacy of innovation in investment management and philanthropy, impact investing is one of Threshold Group's core areas of practice. Before the creation of Canopy, a few of Threshold Group's clients were looking for ways to share the high costs of investment research and enable them to collaborate with each other on mission-aligned investment opportunities. Many of these same clients shared a mutual interest in a place—the Pacific Northwest—and issues related to regional economic development. Through this intersection, Canopy was born.

Understanding the challenge

Each foundation involved in Canopy cares about slightly different issues and different places within the Pacific Northwest, but all were facing similar challenges around regional investing. These foundations had discovered that too often capital markets and investment products were concentrated on global growth opportunities and tended to overlook investment opportunities close to home. Furthermore, they had found that most institutional investors and their investment advisors were narrowly seeking investments along the standard risk-reward continuum, simply looking to maximize investment return on a risk adjusted basis.

Like most institutional investors, Canopy's founding members were all seeking investments with strong financial returns for the 95 percent of their endowment that the IRS does not require them to distribute annually. However, at the same time, they were looking for new ways to put their investment capital to work in support of and in alignment with their grant-making initiatives. With their common interest in the Pacific Northwest, Canopy's founders determined to contribute some of their assets to support community-driven investment solutions.

Finding investment opportunities close to home might seem a simple goal. However, Canopy's founders quickly ran into significant hurdles. At first, each foundation was hunting for local investment opportunities on its own, and each was at a different step in the investment process within their own organization. Furthermore, Canopy's founders each had relationships with different investment consultants and wealth managers, complicating efforts to collaborate on investing using local, niche-oriented investment strategies. Discovering local investment prospects requires a large amount of fresh research; plus new and high quality investment opportunities, such as locally oriented venture capital funds, are difficult to find. The difficulty of obtaining benchmarks for local opportunities challenges investors, wealth managers, and investment consultants seeking to make a business case for regional investing.
Adding to the challenge was the lack of visibility of nascent investment funds and the underdeveloped network of financial intermediaries in the Pacific Northwest region focused on place-based investment strategies. Funds without substantial track records do not meet the standard selection criteria of investment consultants advising institutional investors. This creates major hurdles for first-time funds and provides a significant barrier to unlocking capital in the region.

In addition, many funds have finite life cycles. These finite terms, intended to provide investors with confidence regarding the timing of returns of capital, may force investors to exit portfolio companies prematurely, limiting a fund's ability to maximize both financial returns and community outcomes. Successful place-based investment often requires more patient capital. Furthermore, thematic and narrowly focused geographic strategies involve high transaction costs and have a smaller pool of potential investment opportunities, which prevents them from absorbing large capital commitments from institutional investors. Canopy's founders needed a solution to address these market dynamics.

Three keys to building a new investment approach

As Canopy began to take shape the challenge was clear. Next Canopy had to find the best model to support its approach to regional investing. The team sat down with The Russell Family Foundation, Meyer Memorial Trust, and The Laird Norton Family Foundation, as well as other leading foundations, attorneys, accountants, and thought leaders to design Canopy. The firm spun out as an independent company in early 2015.

After a year of market research, Canopy was able to frame its mission in terms of seven core investment beliefs. **See sidebar for details.** Essentially, Canopy came to see that each community is its own investment ecosystem, requiring access to both debt and equity capital. Additionally, Canopy's leaders understood that they needed to find new ways to unlock capital currently held in silos in one part of a region that were inaccessible to others.

To act on these core beliefs, Canopy developed three strategic offerings: Canopy PLACES, Canopy CAPITAL, and Canopy CATALYST. Together these three offerings balance needs of the supply side (investments) with the requirements of the demand side (investors), and thus, holistically target regional outcomes. According to the broad plan, Canopy would act as a sort of general contractor in the regional investment ecosystem, forging various partnerships with other organizations already active in the region.

Canopy PLACES™: PLACES is Canopy's investment ecosystem mapping arm. In partnership with the University of Oregon and other educational institutions, Canopy collects strategic research on the capital landscape in the Pacific Northwest. Canopy analyzes points of connection among regional stakeholders, as well as gaps in capital flows, which it uses to discover investment opportunities, identify unique collaborations among regional stakeholders, and develop future strategic initiatives. Canopy is also building an interactive online map to share this information publicly and highlight capital flows.

Canopy CAPITAL™: CAPITAL is Canopy's investment arm. Through strategic partnerships with investment consultants, Canopy provides its members with investment research on regionally focused investment funds. Opportunities identified through Canopy PLACES research data is used to populate Canopy CAPITAL's regional investment pipeline. Canopy also uses the investment research process as a way to provide feedback to regionally focused fund managers to help strengthen the investment pipeline.

Canopy's Seven Core Beliefs

1. Communities are their own unique investment ecosystems. Defined by a mix of place, people, values, and beliefs, every community presents unique challenges, has unique needs, and offers specific investment opportunities. Canopy exists to create connections between groups and individuals that might not otherwise collaborate but that, together, hold the capital to empower local solutions.
2. Regions must leverage all types of capital to generate place-based investment solutions. A thriving regional investment ecosystem incorporates strategies that appeal to both equity and debt investors, who have differing community priorities, risk tolerance, return expectations.
3. Investor silos are one of the primary roadblocks to regional investing. Cross-sector partnerships are necessary to unlock capital at a community level. No single investor—public or private—has the necessary mix of domain expertise, investment capacity, and community knowledge to tackle the challenges communities face alone. Radical transparency is necessary to ensure investor collaboration.
4. Local leaders need a voice in developing investment solutions. Investment capital cannot enable true innovation without leadership. Local thought leaders and stakeholders provide critical insight and community capital that global capital markets have tended to overlook. Shared governance among local leaders is integral to ensuring that coordinated investments align with community generated solutions.
5. A thriving regional investing ecosystem will act as an intermediary to meet the unique requirements of place-based investing. Communities lack the capacity to absorb investments at the scale that drives global capital markets. The same innovation and rigor investors use to build today's capital markets can support the development of healthy regional capital markets.
6. The design of investment solutions must include management for regional outcomes. Metrics quantify social and environmental performance, but often do not focus sufficiently on future outcomes. Creating systems to intentionally manage for community outcomes will help foster alignment between investment returns and community priorities.
7. Now is the right time to test these ideas together and move towards a stronger regional economy. The current imbalance of supply and demand for regional investments presents real opportunity for new collaborations and community driven solutions.

Canopy CATALYST™: CATALYST is Canopy's education and capacity building arm. Through this work, Canopy is developing a program to train fund managers and entrepreneurs on how to successfully structure impact investment funds, raise capital from institutional investors, and deploy capital in a disciplined and effective manner. Canopy CATALYST is also working to educate investors and investment advisors on key elements of regional investing. Through "Communities of Action", Canopy CATALYST will tackle problems relevant to specific capital gaps in the region. The first Community of Action is focusing on how to deploy capital to enhance rural economic development in the Pacific Northwest.

Structuring Canopy

Defining Canopy's core goals and service offerings was the first step, but the second step was equally important: how best to structure Canopy? Canopy needed an organizational structure that would allow its founding members to simultaneously pursue all three services outlined above, while also attracting other investors. Canopy's founders considered various structures: C-Corporations, S-Corporations, Limited Partnerships (LPs), Limited Liability Companies (LLCs), Low-Profit Limited Liability Companies (L3Cs), Benefit Corporations, Social Purpose Corporations, and tax-exempt or 501(c)(3) organizations, as well as various combinations of these alternatives. The chosen structure had to meet the following objectives:

- keep Canopy as flexible as possible
- balance Canopy's social purpose and investment objectives
- optimize tax efficiency for potential members, recognizing that Canopy's founding members were 501(c)(3) organizations
- allow simultaneous membership or ownership by private foundations, government entities, corporations, and individuals
- create a workable revenue model in the future, based on membership fees, subscriptions, or, potentially a fee-for-service structure
- enable equity investments, PRIs, and grants to capitalize Canopy simultaneously

Moreover, Canopy's structure had to reflect the complexity of the work the organization is undertaking, as well as highlighting systemic issues that limit collaboration across sectors. Canopy's founders also wanted to address the many structural and legal issues within philanthropy that complicate and often challenge the ability of private foundations to direct capital—either grants or investment corpus—to companies that do not fit the current for-profit and nonprofit paradigm. The structure selected for Canopy had to be flexible regarding investors' level of commitment, both financially and in terms of governance. Canopy's founding members recognized that shared governance and the concept of collective control is a unique characteristic of the business model likely to attract a broad contingency of investors. Finally, the founding members had to build into Canopy's structure limited liability for investors, which is a hallmark of most investments.

Ultimately Canopy settled on a LLC structure because, with help from its advisors, it determined that an LLC structure was the most useful vehicle to enable multiple private foundations and other participants to pool their resources to pay for MRI research and capacity building programs. A LLC is simple, flexible, and transferrable. Each member owns a pro rata share of Canopy. From a tax standpoint, each member is deemed to engage directly in its proportional share of the LLC's activities. Since Canopy's three founding members are private foundations, the LLC structure also helps address specific legal issues related to private foundations, such as self-dealing, unrelated business taxable income (UBTI), and excess business holdings.

Compared to a C-Corporation, an LLC is a more favorable legal structure for Canopy because Canopy's members avoid the high tax rates levied on corporations and the double tax regime imposed on C-Corporations and their investors. An S-Corporation avoids double taxation and is fundamentally a pass-through organization, meaning all of the income, regardless of whether it is derived from active or passive investment, passes through the organization to the tax-exempt owner as unrelated business income. This income is subject to tax at corporate or trust rates, depending upon the characteristics of the owner.

Both C-Corporations and S-Corporations provide the desired limited liability for members, but their tax inefficiency disqualifies them as viable choices for Canopy. Similar to the S-Corporation, alternative flow-through structures such as LPs or LLCs do not pay federal income tax at the entity level. Flow-through organizations are essentially conduits for their members. Each member can determine the treatment of income activities individually, rather than having activities taxed at both the members' level and at the entity's (Canopy's) level.

However, from a governance standpoint, an LLC is favorable to an LP. LLC governance is generally designated in the LLC agreement, and may be structured in any way that best suits the needs of the specific entity, whereas LPs typically have a general partner and a set of limited partners, as is common among commingled investment funds. Limited partners hand off decision making to the general partner, typically the management team, and have very little involvement in the company's day-to-day activities and investment decisions. In exchange, the general partner bears personal liability. Because Canopy wanted hands-on governance, with all members benefitting from limited liability, an LLC structure was preferable to an LP.

The founders also considered whether to form Canopy as a charity under Internal Revenue Code section 501(c)(3), since some of Canopy's activities were expected to be charitable in nature. Moreover, at the time of Canopy's founding, all of its potential members were also tax-exempt organizations. However, structuring Canopy as a tax-exempt charity would have prohibited members from owning an equity interest and would have restricted the types of activities that Canopy could pursue. It also would have restricted hands-on governance by members.

Canopy LLC

Designed to help regional stakeholders contribute to community economic development, Canopy was intentional about aligning its corporate structure and its service offerings. However, Canopy has other qualities that will help it achieve meaningful results.

1. **Canopy's design makes it flexible.** Canopy is familiar with the problems its community is trying to solve today, but what if these problems change? What if regional stakeholders change or community needs change? By structuring the organization as an LLC, Canopy is able to pursue its mission through multiple avenues, partnering with the widest range of organizational types, including foundations, government, corporations, and individuals. Canopy has also built in the flexibility to change its revenue model over time.
2. **Canopy's members drive its activities.** Canopy knows that its activities are relevant to the Pacific Northwest because the investors and other stakeholders who are driving it both understand and care deeply about the region. Canopy's top priority is to enable a high level of member and community participation in its mission and activities. Because people who live in the communities often have the most creative and practical solutions to regional problems, Canopy is designed to enable community-driven investment activities. Governed by its members, who have collective control over the company, Canopy's members are its owners. Their interests align with Canopy's activities and with Canopy's success in executing its mission.
3. **Canopy provides a public good.** Canopy's design balances charitable purpose with investment objectives. Canopy's fundamental goals include scalability, self-sustainability and, eventually, the ability to transfer its model to geographic regions outside the Pacific Northwest. Many of Canopy's activities, particularly those of Canopy PLACES and Canopy CATALYST, will make this future transition possible by building knowledge in the field and providing strategic research to inform potential place-based investors elsewhere.

   Canopy's focus on delivering a public good has made it attractive to a wide variety of stakeholders. Canopy's LLC structure give charities various options regarding how they will participate. For instance, private foundations can make equity contributions or PRIs, if the investments significantly further the foundation's charitable purpose. Private foundation investors may be able to count PRIs or grants that they make to Canopy toward their annual distribution requirements. Because Canopy's founding members are 501(c)(3) private foundations, Canopy includes in its founding documents language that forbids Canopy from engaging in any activities prohibited to private foundations.

4. **Canopy understands that adaptation, collaboration, and careful judgment are vital to building a strong organization.** As a start-up building a unique model, Canopy is piloting its activities in a single region. Canopy has entered into strategic partnership with many reputable organizations and service providers to help execute its mission successfully. As a small team, Canopy relies on its partners for their networks and their deep domain expertise. Canopy is always on the lookout for new opportunities to grow and to add value to the regional investment ecosystem.

Who should get involved

Canopy's mission is to develop the investment ecosystem in the Pacific Northwest and, eventually, to extend this mission to other parts of the United States. Canopy recruits investors who want to build social and economic infrastructure to align capital markets with community outcomes. These may be private foundations with a mission rooted in place, community foundations that want to put their corpus capital to work in support of their donor advised funds, or small and understaffed rural foundations that would benefit from access to Canopy's resources. Small foundations with no dedicated investment staff can benefit from access to Canopy's training curriculum through Canopy CATALYST, as well as source ideas from Canopy CAPITAL's investment pipeline.

Canopy is building a robust and sustainable network of corporations, entrepreneurs, fund managers, government agencies, and individuals. To achieve its mission, Canopy encourages transparency and networking to help its members connect with each other, as well as community and local investment opportunities.

We at Canopy hope that you have found this case study educational, and that we can find a way for you to become involved in our work. *Together we can build this great place.*

For more information on Canopy, visit **www.investcanopy.com** or e-mail **info@investcanopy.com**.

Additional Resources

Please refer to the resources below for additional information on MRI, PRI, and place-based investing.

Arabella Advisors, Exponent Philanthropy, and Mission Investors Exchange. "Essentials of Impact Investing: A Guide For Small-Staffed Foundations", 2015.

Brun, Albert V., Steven Godek, Patrick Guerra, Charly Kleissner, Raul Pomares, and Hersh Shefri. *Solutions for Impact Investors: From Strategy to Implementation.* New York: Rockefeller Philanthropy Advisors, 2009. *www.issuelab.org/resource/solutions_for_impact_investors_ from_strategy_to_implementation.*

Buchanan, Phil, Jennifer Glickman, and Ellie Buteau. "Investing and Social Impact: Practices of Private Foundations." Research Report, The Center for Effective Philanthropy, Cambridge, Mass., May 2015. *www.effectivephilanthropy.org/wp-content/uploads/2015/05/Investing-and-Social-Impact-2015.pdf.*

Cambridge Associates and Global Impact Investing Network. "Introducing the Impact Investing Benchmark." Report, 2015. *http ://40926u2govf9kuqen1ndit018su.wpengine. netdna-cdn.com/wp-content/uploads/2015/06/Introducing-the-Impact-Investing-Benchmark.pdf.*

Kirby, Scott. "Align Your Portfolio with Your Values: A Straightforward Guide to Fixed Income Impact Investing." Paper, RBC Global Asset Management, Minneapolis, June 2014. *https://us.rbcgam.com/resources/docs/pdf/whitepapers/RBC_Impact_Investing_6.14.pdf.*

Levitt, David A. "Investing in the Future: Mission-Related and Program-Related Investments for Private Foundations." *The Practical Tax Lawyer,* spring 2011. *www.adlercolvin.com/ pdf/PTXL1105_Levitt.pdf.*

Mission Investors Exchange and Council of Foundations. "Community Foundation Field Guide to Impact Investing: Reflections from the Field and Resources for Moving Forward." Seattle, September 2013. *www.missioninvestors.org/system/files/tools/FieldGuide_102113_ PRINT_v3.pdf.*

World Economic Forum. "Impact Investing: A Primer for Family Offices." Report, Geneva, Switzerland, December 2014. *www3.weforum.org/docs/WEFUSA_FamilyOfficePrimer_ Report.pdf.*

About the Authors

Sarah Mahlab is Associate Director of Innovation and Investments at Canopy. In this role, she supports the ongoing development and implementation of Canopy ecosystem mapping and investment business models, working with partners on strategic research. Before her association with Canopy, Sarah worked at The Lyme Timber Company, a conservation-oriented timberland investment manager. She holds a bachelor's degree in environmental analysis from Pomona College and an MBA from Tuck School of Business at Dartmouth.

Brad Harrison is Director of Strategy at Canopy. In this role, he supports efforts to direct capital to projects that need it most and builds infrastructure to strengthen the regional investment ecosystem. Brad is also an Impact Investing Strategist at Threshold Group, where he conducts research on investment opportunities that seek to achieve social, environmental, and economic development outcomes both regionally and globally. Brad has previously worked for Green Building Services and Ecotrust/Ecotrust Forest Management. He holds a bachelor's degree in applied economics and management from Cornell University and a master's degree in environmental management from Yale University.