

Introduction

A healthy society gives rise to healthy markets. When housing, jobs, healthcare, or public resources are unavailable, exploited, depleted, or left fallow, productive activities in which investments take root, wither and in extreme cases, disappear. Community investments are essential to the health of society, and therefore are critical to the health of the marketplace.

Section I – Community Investments: Fact and Fiction

- ☒ Community investments are illegal and concessionary.
Truth: They are not. Many offer market rates and are insured.
- ☒ Community investments are time-consuming.
Truth: Some are; many are not.
- ☒ Community investments are costly to administer.
Truth: A rising level of sophistication is reducing transaction costs.
- ☒ Competent managers are unavailable.
Truth: A growing list of managers and intermediaries is available, see FAQ section below.
- ☒ Convincing trustees and professionals to make community investments is impossible.
Truth: Legions of investors and plan participants are calling for a more proactive policy regarding community investments.
- ☒ Politics always get in the way.
Truth: This is not always the case, however, when politics do get in the way, institutional investors and committee members are compromising the integrity of their fiduciary responsibilities and are at risk of litigation for breaching the exclusive benefits rule, the prudent man rule, or other statutory mandates issued by the Department of Labor, IRS, SEC or Department of Justice.
- ☒ Benchmarks are not available to measure community investment performance.
Truth: Standard benchmarks for measuring the performance of any investment are readily available. Remember: risk-adjusted market rates of return are mandated for portfolios subject to ERISA.

FAQ: Education

Q: Are there educational or training opportunities for institutional investors that address fiduciary duties and investment strategies?

A: Yes. Training is available through a number of organizations, including:

George Meany Center for Labor Studies

<http://www.georgemeany.org/>

The Center for Working Capital (AFL-CIO)

<http://www.centerforworkingcapital.org/>

U.S. Department of Labor

<http://www.dol.gov/ebsa/regs/fedreg/>

Institute for Fiduciary Education

<http://www.ifecorp.com/>

Section II - ERISA and the Exclusive Benefits Rule

Community Investments are Permissible

The Employee Retirement Income Security Act (ERISA) was created to protect private pension fund participants and beneficiaries. any investment is permissible contingent upon compliance with procedural mandates.

Interpretive Bulletin 94-1:

This includes giving appropriate consideration to the role that the investment or investment course of action plays (in terms of such factors as diversification, liquidity and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility.

FAQ - ERISA & EXCLUSIVE BENEFIT

ERISA [29USC1104 A(1)(c)] obligates private pension investors to diversify their portfolio, unless doing so would not be prudent. It is important to underscore the role of diversification across investment classes; it is not enough to diversify on the basis of geographies, companies, or industries.

Section III – Prudent Man Standard of Care

The prudent man standard of care states “that a fiduciary shall discharge his duties with respect to a plan with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”¹

Section IV -Technical Barriers

The community investment environment is as dynamic as the mainstream marketplace (capital markets) dominated by large multinational banks and investment firms; the most noteworthy differences are scale and mission. Many of the reasons cited by institutional investors for not being more active with community investments, touch upon three areas of concern: legitimacy, viability and versatility.

Section V - Regulatory Barriers

Community investments are permissible under ERISA provided they do not sacrifice the interests of plan beneficiaries.

Section VI - Institutional Barriers

The community development sector is working to address a number of existing challenges, real and perceived, that prevent institutional investors from accessing viable community investments, such as those embedded in the institutional culture in which investment decisions are made. The real barriers, as outlined in the technical and

¹ Code of Federal Regulations, Title 29, Volume 9, Revised as of July 1, 1999, U.S. Government Printing Office via GPO Access. P.445-446

regulatory sections of this primer can be surmounted through education and advocacy. So too, can the institutional barriers, many of which are based on misperceptions of the community development sector.

Section VII - Community Investments

Expanding Options for Institutional Investors

This speaks directly to the concern institutional investors have about portfolio design: there is no regulatory template mandating asset allocation. Again, the rules address procedural issues, not investment outcomes.

Investment Description	Asset Class	Risk Level	Social Focus
Auction Rate Securities (ARS)	Bond	Low	Jobs, Wealth, Business
Certificates of Deposit (CDs)	Cash	Low	Wealth
Collateralized Debt Obligations	Equity	Medium-High	Jobs, Wealth, Business
Collateralized Mortgage Obligations (CMO)	Real Estate	Medium-Low	Wealth, Housing, Business
Commingled Real Estate and Mortgage Accounts	Real Estate	Low	Wealth, Housing, Business
Direct Investment	Equity	Medium-High	Jobs, Wealth, Business
Linked Deposits	Cash	Low	Wealth
Pooled Investment Funds	Equity	Low	Jobs, Wealth, Business
Private Placements	Equity	Medium-High	Jobs, Wealth, Business
Real Estate	Real Estate	Medium	Wealth, Housing, Business
Secondary Capital	Debt	Medium	Jobs, Housing, Business
SBA 7(a) Loans	Debt	Low	Jobs, Housing, Business
SBA Certified Development Company (504) Loans	Debt	Low	Jobs, Housing, Business
Small Business Investment Companies (SBICs)	Equity/Debt	Medium	Jobs, Wealth, Business
SBA New Market Venture Capital	Equity/Debt	Medium	Jobs, Wealth, Business
Variable Rate Demand Notes (VRDNs)	Bonds	Medium	Jobs, Housing, Business
Venture Capital	Equity	High	Jobs, Wealth, Business

Section VIII - Risk

RISK ADJUSTED RATES OF RETURN – FIXED INCOME VEHICLES

Community investments made by pension funds need to achieve risk-adjusted rates of return equal to or better than alternative investments with similar risk characteristics.

RISK MITIGATION

Risks associated with loss of investment principal, interest, or equity can be managed using a number of techniques.

RISK-ADJUSTED RATES OF RETURN – COMMUNITY DEVELOPMENT VENTURE CAPITAL

Investments in a Community Development Venture Capital (CDVC) fund should yield a rate of return similar to returns indicated in vintage year analyses, taking into account such factors as initial capitalization, assets, debt, equity, management and business objectives.

SECTION IX – INSTITUTIONAL INVESTORS

Community investments may or may not be prudent depending on a number of factors, including diversification of current holdings, risk tolerance, cash flow needs, plan documents, timing, due diligence and general economic conditions. The type of institutional investor has some bearing on the investment decisions, particularly regarding regulatory compliance. Exercising prudence should characterize all institutional investment activities, and investors are reminded that what may be a prudent investment for one investor, may not be for another. The following table identifies key considerations by investor type.

Investor Type	SEC Compliance Required	ERISA Compliance Required	Diversification Federally Mandated*	State and/or Local Statutes
Public Pension Funds	Yes	Yes, under section J	Yes (State & Federal)	Yes
Private Pension Funds	Yes	Yes	Yes	Yes
Mutual Funds	Yes	No	By prospectus only	Yes
Religious Funds	Yes	Yes (Title 1, Section 3(33))	Yes	Yes
Taft-Hartley Funds	Yes	Yes	Yes	Yes
Corporate Investors	Yes	No	No	Yes
Foundations	Yes	No	No	Yes
Insurance Companies	Yes	No	Yes	Yes

SECTION X - TAX CREDITS

New Market Tax Credits – Qualified Investments

The purpose of the New Market Tax Credit (NMTC) is to spur private investment in low-income urban and rural communities. The program is based on the idea that there are viable business opportunities in low-income communities, and that a federal tax credit would provide an attractive incentive to increase the flow of investment capital to such areas." (Excerpt from *Making the New Markets Tax Credit Count*)². NMTC's are distributed by geography and entity.

FAQ: NMTC

How the New Markets Tax Credit Works

Qualified community development entities (CDEs) apply to the U.S. Department of Treasury's Community Development Financial Institutions (CDFI) Fund for an allocation of the new markets credit. Both the CDE and its private equity investors are allocated tax credits.

What is a Qualified CDE?

Any U.S. corporation or partnership with a primary mission to serve, or provide investment capital for, low-income communities or persons; and, it must be certified by the CDFI Fund of the Department of Treasury.

How much is the credit worth?

You claim the credit over a period of 7 years. To find the amount of your credit each year, multiply the amount you paid the qualified CDE for your qualified equity investment by a percentage.

² Rapoza, R. Making the New Markets Tax Credit Count. Federal Reserve Bank of San Francisco 08/03

What is a Qualified equity investment?

It is the cost of any stock in a corporation or any capital interest in a partnership in which the corporation or partnership is a qualified CDE, the investment is acquired on the original issue date for cash.

What is a Qualified low-income community investment?

It is usually any capital or equity investment in, or loan to, any QALICB.

How are the New Markets Tax Credits Allocated?

They are allocated annually by the CDFI Fund to CDEs under a competitive application process. The maximum amount of qualified equity investments designated by the qualified CDE cannot exceed the amount of the allocation received from the CDFI Fund.

Low Income Housing Tax Credits

The Low Income Housing Tax Credit (LIHTC) has increased affordable housing by 1 million units. The Act was created to encourage the development of rental housing for low-income households.

The National Equity Fund, Inc. <http://www.nefinc.org/> is a major syndicator of LIHTC's, investor equity base and impact.

Section XI - Secondary Markets

There have been a number of initiatives to create a secondary market for community investments. The field is in its infancy, but early indications strongly suggest secondary markets will continue to grow. Some of the secondary market initiatives are for-member organizations only.

Section XII - Impact Metrics - Assessing Social Impact

There are a number of criteria by which community investments can be measured, some of which are readily ascertained and immediate, while others have long-term significance and are difficult to measure. Measurements vary depending upon the type of investment.

The Roberts Enterprise Development Fund offers an interactive resource for measuring social return on investment.³ Investors can input their data to achieve a host of feedback, including: social purpose value, enterprise value, blended value, social purpose index of return, enterprise index of return, blended index of return, and other data. The social impact tool can be accessed at:

<http://www.redf.org/download/sroi/SROIExcelModel.xls>

Generally, institutional investors who make community investments do so with the dual purpose of generating financial returns and having a social impact. Factors that can be quantified when measuring social return on investment requires looking at a host of

³ The Roberts Investment Excel Model is no longer used by REDF, as they have adopted their proprietary OASIS (Ongoing Assessment of Social Impacts) evaluation application. They do acknowledge, however, the sustaining value the Excel system provides individuals and organizations engaged in measuring social impact.

outcomes, including job creation/preservation, wage indices, employee migration (new jobs, promotions, departures, retired, terminated), houses built/refurbished for low and moderate-income individuals (owner occupied, rentals), children and family services created, and number of bank accounts opened and maintained.

Comprehensive assessments include collecting data on a regular basis on everything from community and individual assets to the number of employees, customers, or clients that a particular initiative generates.

The Low Income Housing Tax Credit (LIHTC) is considered by many to have had a high social impact.

Organizations with an expertise in community audits can provide an objective analysis of community assets and needs prior to an investor making an investment, particularly regarding the work force.

Section V – Appendices

Appendix I – Operating Methods & Functions

Management of assets, particularly pension and institutional funds, requires familiarity with the regulatory environment, the market place and the needs and interests of the fund shareholders. Given their fiduciary responsibilities, institutional investors are advised to adopt best practices in the management of client or plan participant assets.

The following list identifies operating methods and functions. The table provides information on the type of function, who is responsible, and the suggested frequency for executing the function.

Operating Topic	Function / Facilitation	Execution
Accounting Requirements	Operations / Committee / Staff	Ongoing
Advisor Contracts	Operations / Committee	Quarterly
Asset management	Operations / Committee / Advisors	Ongoing
Benchmarking & Performance Monitoring	Executive / Committee / Staff	Monthly
Compliance reviews	Executive / Committee / Staff	Quarterly
Conflict of Interest	Governance / Board	Annually
Diversification	Operations / Committee / Advisors	Ongoing
Document (Plan Design)	Executive / Committee / Board	Annually
Document Management	Operations / Committee / Staff	Ongoing
Due Diligence	Operations / Committee /	Ongoing
Investment Strategies & Policies	Governance / Committee / Board	Quarterly
Minimum Reserves	Executive / Committee / Board	Annually
Partnerships	Operations / All	Ongoing
Portfolio Design	Executive / Committee / Advisors	Quarterly
Prudent Man Rule	All/All	Ongoing
Reporting requirements	Operations / Committee / Advisors	Quarterly
Shareholder Advocacy	Operations / Committee / Staff	Ongoing
Training	Operations / All	Ongoing
Watch lists	Operations / Staff / Advisors	Ongoing
Workout plans	Operations / Staff / Advisors	Ongoing

