NATIONAL ROUND TABLE ON THE ENVIRONMENT AND THE ECONOMY

CAPITAL MARKETS AND SUSTAINABILITY PROGRAM

SCAN OF THE COMMUNITY INVESTMENT SECTOR IN CANADA

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September, 2004.

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EXECUTIVE SUMMARY

Most of the attention and strategizing around whether and how capital markets can lever sustainability – improved social and environmental conditions in Canadian communities – goes to considerations of whether there are links between sustainability and financial performance. Relatively little attention is placed on the potential of the fledgling Canadian community investment sector – one of the three pillars of socially responsible investment – to advance sustainability at much more local levels. This paper is a beginning attempt to bridge the gap in awareness of the community investment sector as a sustainability driver and to identify the operating constraints confronting the sector in today's marketplace.

Community Investing is defined as investment for the purposes of financing deep-seated needs of local communities not addressed by mainstream finance, including poverty alleviation, community and co-operative development and environmental regeneration and, for the purposes of this paper, includes Economically Targeted Investing and Sustainable Venture Capital – additional investment strategies that generate double and triple bottom line returns for investors and communities.

This paper takes a unique perspective in its analysis – that of the investor or fund manager, who is called upon to consider looking at the track record of the American CI experience where market and near market rates of return are possible. The US track record has proved that many CI investments are non-concessionary, low to no risk and viable asset allocation strategies. It is generally concluded that while the CI sector is very small in Canada, if similar supports were available as those in the US, its scale and impact could considerably increase. Specifically, a leadership role by the federal government, including a favourable tax and regulatory regime, operating and capital programs and other supports as well as strengthened industrial infrastructure such as intermediaries, networks, product standardization, investor education and awareness, etc. could go a long way to significantly scaling up the sector. Following the American lead, a Canadian version of the Community Reinvestment Act could provide similar impetus for the sector's development.

The paper notes that sub-markets such as those found in Aboriginal communities, where opportunities go unexplored because of the lingering perceptions of risk and security constraints, languish for lack of better information of the gaps and opportunities. In the US such underserved markets, often perceived as high-risk, are proving themselves to be viable investment niches.

Within the paper these underserved markets not well understood by the traditional financial sector are placed within a social capital market framework. Located on the

investment continuum between traditional finance and philanthropy, the social capital market is viewed as generating both a social and financial return, that is, a "blended return". The paper touches on the potential of advances in understanding of social (including environmental) returns on investment and social value creation to attract further interest in the CI sector as a means to lever sustainability benefits over the long term.

This paper, admittedly, raises more questions than it provides answers regarding the Community Investment sector in Canada, but if it has served to also raise the awareness and interest amongst readers as to the role it might play as a capital market strategy for advancing sustainability it will have met its objectives.

TABLE OF CONTENTS

ACRONYMS

ACC	Aboriginal Capital Corporations
ACFDC	Aboriginal Community Futures Development Corporations
ACOA	Atlantic Canada Opportunities Agency
AFI	Aboriginal Financial Institutions
AIM	Alternative Management Investment
BCIMC	British Columbia Investment Management Corporation
BEA	Bank Enterprise Award
CalPERS	California Public Employees' Retirement System
CCEDNet	Canadian Community Economic Development Network
CDC	Community Development Corporations
CDCU	Community Development Credit Unions
CFDABC	Community Futures Development Association of BC
CFDC	Community Futures Development Corporations
CDFI	Community Development Financial Institutions
CDLF	Community Development Loan Funds
CDMB	Community Development Municipal Bonds
CDP	Caisse de Dépôt et Placement du Québec
CDVC	Community Development Venture Capital Funds
CED	Community Economic Development
CEDIF	Community Economic Development Investment
CERES	Coalition for Environmentally Responsible Economies
CI	Community Investing
CRA	Community Reinvestment Act
CRAQIF	CRA Qualified Investment Fund
CSN	Confédération des Syndicats Nationaux
DBL	Double Bottom Line
DÉC	Dévélopment Économique Canada
EQ2	Equity Equivalent Investments
ERISA	Employee Retirement Income Security Act
ETI	Economically Targeted Investing
FAQDD	Fonds d'action québécois pour le développement durable
FEÉCQ	Fonds d'emprunt économique communautaire de Québec
FIDD	Fonds d'investissement en développement durable
GAO	General Accounting Office
HOOPP	Hospitals of Ontario Pension Plan
IPPC	Pollution Prevention and Control
LIHTC	Low Income Housing Tax Credit
LSIF	Labour-Sponsored Investments Funds
MSCI	Morgan Stanley Capital International
NMTC	New Market Tax Credit
OISE	Ontario Institute for Studies in Education
OMERS	Ontario Municipal Employees Retirement System
PMIA	Pooled Money Investment Account
PCV	Pacific Community Ventures

RRSP	Registered Retirement Savings Plan
SCP	Social Capital Partners
SDTC	Sustainable Development Technology Canada
SIF	Social Investment Forum
SIO	Social Investment Organization (Canada)
SOCARIAQ	Société de Capital de Risque Autochtone du Québec
SRI	Socially Responsible Investment
SROI	Social Return On Investment
SSHRC	Social Sciences and Humanities Research Council
SVC	Sustainable Venture Capital
VC	Venture Capital
WD	Western (Economic) Diversification

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1. INTRODUCTION

Increasing attention is being placed on the role of capital markets and their potential for levering positive sustainability outcomes. Much of the effort to date has looked at the degree to which there are links between sustainability and financial performance. This paper looks at the issue of sustainability and capital markets from a different perspective. It seeks to assess the potential of capital markets – the trading of debt or equity securities – to generate positive social, economic and environmental outcomes for communities, regions, disadvantaged groups, and under-invested sectors. In other words, this paper explores whether there is evidence that institutional and retail investors can invest proactively to fill capital gaps and advance sustainable development of communities and regions without compromising their financial objectives.

The Socially Responsible Investment industry (SRI), which has emerged to become a significant force in capital markets over the past few decades, is the home for targeted investing which generates double and triple bottom line returns. Called community investing (CI), this sub-sector of mainstream investment has grown significantly in the US and struggles for legitimacy in Canada. In order to better understand this sub-field of community investing and related asset allocation strategies of economically targeted investing (ETI) and sustainable venture capital (SVC), this paper will cover the following:

- Description of the sector and a comparison between Canadian and US community investment industries;
- A literature review that looks at the critical issues confronting the sector in both Canada and the US;
- Examples of best practice in community investment, economically targeted investing and sustainable venture capital;
- A review of the capital allocation processes fund managers typically follow in their decision to place double and triple bottom line investments, including fiduciary considerations; and
- Barriers and opportunities to growing the size, scale and impact of the community investment sector in Canada.

This is admittedly a significant field of study, which cannot be considered in depth in a short introductory paper. This paper is thus a high level scan of the challenges and potential of the CI sector which aspires to point the way for further debate and research to address the issues presented above. Conducted over one month in the summer of 2004, the study is based on recent Canadian and US literature in the fields of CI, ETI and SVC and interviews with US and Canadian academic and industry leaders. The capital allocation process was developed through key informant interviews with five US and Canadian fund managers representing two mutual funds and a special account manager, pension fund and foundation. Collectively they manage over $100 million in community investments, from an asset base of $3.7 billion[1]. They also provided insights into the barriers and opportunities confronting the CI sector in both countries.

The rationale for community investing is that public capital markets and traditional financial intermediaries such as banks overlook or are structurally biased against non-traditional investments. Community investments are designed to fill this capital market gap. As will be discussed below, such investments can yield "at market", "near market" and "below market" returns[2] and differ from charitable donations in the expectation of financial returns – in addition to social returns – hence the expression "double bottom line".

The following analysis is primarily based on the definition of community investment developed by the Canadian SRI industry, elaborated below. For the purposes of this paper, community investment is also defined to include the related sectors of economically targeted investing (ETI) and sustainable venture capital (SVC). These additional investment approaches also represent targeted investment strategies, often for institutional investors such as pension funds, as will be explored further. Specifically, ETI is defined as institutional asset allocations that obtain both market-grade returns commensurate with risk and collateral (social) benefits by addressing perceived financing gaps and under-investment. Sustainable Venture Capital refers to the sub-sector within the venture capital industry that proactively invests in social and environmental technologies, processes and enterprises within professionally managed venture capital portfolios.

It is important to note that due to the infancy of the CI sector as a legitimate asset class and to the explosion of largely American innovation in this capital market sub-sector, the definition of community investment is still in evolution. As such, the approach taken in this paper should be perceived as a snapshot in time, again for the purposes of highlighting a little understood but high impact asset allocation strategy.

As the literature review and analysis will reveal, the CI sector is poised for growth in Canada, and with it sustainability benefits in the creation of jobs, affordable housing, regional development, social and environmental enterprise, infrastructure and conservation financing, clean technology, and urban regeneration. For its potential to be

[1] All dollar denominations are in Canadian currencies except where noted.
[2] For the purposes of this paper "at market" refers to risk-adjusted returns benchmarked to traditional financial instruments that most closely approximate the term, rate and risk parameters of the CI investment in question. "Near market" is a term given to investments that generate returns very close to market rates, which when applied across an entire investment portfolio have negligible impact (See Appendix B – Sensitivity Analysis). "Below market" in this context refers to those investments which intentionally result in concessionary returns and are undertaken because they create the greatest social value at the community level. In CI terms, these returns deliver consummate levels of social return to create a blended value proposition for the investor and society. See the Literature Review for a discussion of blended value returns.

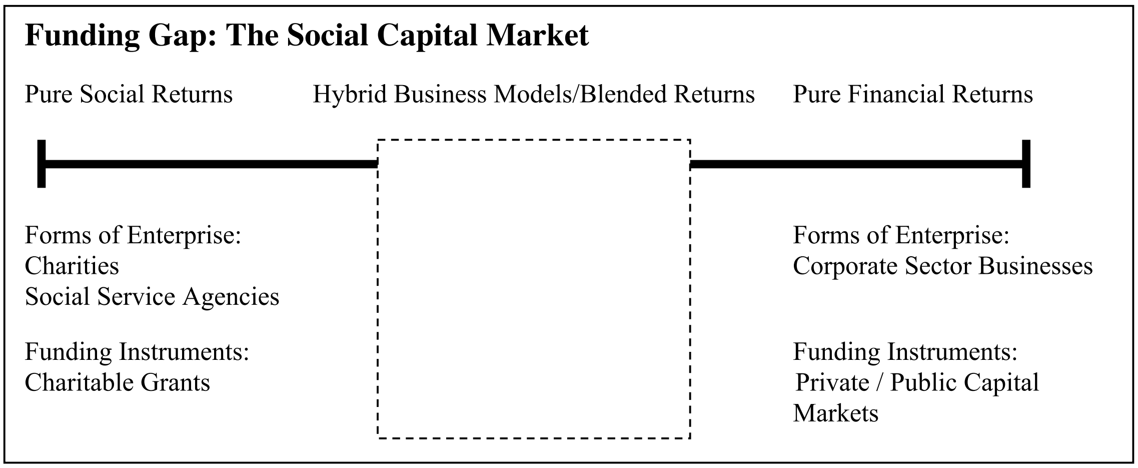
realized, however, more research and study will certainly be needed but – much more significantly – other programmatic support, education and awareness is essential.

2. LITERATURE REVIEW: SUMMARY

The following is a summary extract from a more complete literature review on community, economically targeted and sustainable venture capital investing in Canada and the US (see Appendix A for full literature review).

2.1 Community Investing

Traditional financing focuses entirely on financial returns while charitable financing seeks social returns. This leaves a gap in community financing as illustrated in the following figure:



Source: Social Capital Partners, 2003

While risk and rates of return vary widely, CIs finance seemingly "high risk" transactions in a prudent and effective way. Nonetheless, even when we consider the differences in scale, the US dwarfs Canada in their innovation to bridge this funding gap with CI:

- There are 800 – 1000 Community Development Financial Institutions (CDFIs) in the US representing US $14 billion (2003 statistics). CI assets have expanded by 84 percent since 2001 when they were estimated at US $7.6 billion.
- There are 50 or so community investment funds identified to date in Canada, representing $69 million in Canada for 2002, down from $85 million in 2000.

In the US, government legislation and programming have been key drivers of the community investment industry. Canada lacks a broad framework of national legislation and government programming to encourage CI.

2.2 Sustainable Venture Capital Investing

The Sustainable Venture Capital (SVC) market is still maturing, and is mostly in expansion-stage financing as start-up-stage financing is even higher risk. Fund sizes and deal sizes are still relatively small and there is no clear story to tell about their financial success and incomplete stories about their social or environmental impact.

A few conditions are deemed essential to the growth of SVC:

- successful exits from deals and more consistent and reliable financial returns data;
- awareness and education on both 'sides' of SVC investment;
- co-investors (Sustainable Development Technology Canada represents the approach of the federal government on this industry requirement); and
- environmental mitigation regulation imposing internalization of externalities by polluting sources to further facilitate investment in this sector.

2.3 Economically Targeted Investing

SVC or community investing by pension funds and other institutional investors is often referred to as Economically Targeted Investments. ETIs form an investment perspective that, with all else being equal, recognizes collateral benefits such as the creation of jobs, affordable housing or regional economic development. Advocates of ETI argue that the present and future financial health of trust funds is inextricably linked to the economic health of their communities.

Some key points from the literature include:

- Unlike the U.S., there is no broad legal framework in Canada that clarifies and establishes parameters for economically targeted investing;
- A 1995 U.S. General Accounting Office (GAO) survey found that most ETI programs in the U.S. were outperforming their benchmarks;
- In Canada, between 1991 and 1996 close to 17,000 jobs were created by 420 venture-backed companies at an exponential growth rate of 26 percent per year;
- While private and public sector pension funds in the US were typically responsible for approximately 50 percent of all new venture capital on an annual basis during the 1990s, only a handful of extremely large public sector pension funds in Canada are engaging in private placement investment; and
- Labour-Sponsored Investments Funds (LSIFs) control more than 50 percent of the available venture capital market in Canada. Federal and provincial tax credits act as incentives for investment in these funds.

It becomes evident that in the US as in Canada (with the LSIFs), where there is a legal structure and government support, ETIs represent an effective strategy for job and wealth generation.

2.4 Social Impact Metrics

Social impact methodology, similar to the CI sector, is very much a "work in progress", though attempts to further quantify the social and environmental venture field promise to go a long way to bridging the information gap in the social capital marketplace.

A generally accepted standard (such as those for accounting), for social impact accounting does not yet exist. Attribution analysis is an issue, so current working metrics tend to look at outputs rather than true impacts. The Social Return on Investment (SRIO) is one method of assessing social value while the "Blended ROI" is perhaps the ultimate goal in metrics as it integrates both social and financial returns to create a blended value proposition.

The balance of the paper delves into the CI sector in more detail, providing further background to the emergence of this asset class within the investment industry.

3. DESCRIPTION AND ANALYSIS OF THE CANADIAN CI SECTOR

3.1 The Canadian CI Sector

The Social Investment Organization defines community investment as investment for the purposes of financing deep-seated needs of local communities not addressed by mainstream finance, including poverty alleviation, community and co-operative development and environmental regeneration. The SIO does not provide specific statistics on sustainable venture capital or economically targeted investments due to the difficulty in verifying asset values in these investment categories. The 2004 Canadian Social Investment Review, to be released in November 2004, will report on the following CI categories: (1) micro finance; (2) equity and debt financing for co-operatives and not-for-profits; (3) community venture capital; and (4) investments in sustainable ventures operating in local and regional markets.

They exclude in their CI definition assets that have been contributed by government and charitable donations such as those as found within the federally sponsored programs Community Futures Development Corporations and Aboriginal Financial Institutions as these programs are not established to generate investor returns[3].

A small sector by any standard, the CI field in Canada is limited to a handful of investment grade opportunities for the retail and institutional investor. High impact social investors would have to be highly motivated to find appropriate at or near market CI opportunities, given the precarious nature of the CI sector in Canada. The field is marked by the entrance of two mutual funds – Acuity's Social Values Global Equity Fund and Meritas Mutual Funds Inc. – both of whom have committed 3 and 2% respectively of their funds' assets to community investment[4]. Both firms advise in their prospectuses that while rates of return are factors in the selection process, they will be

[3] While Community Futures Corporations are not themselves recipients of significant CI investment, some of their trade associations have acted as intermediaries for institutional investors. The Community Futures Development Association of BC, profiled in this paper, provides an example of the intermediary roles played by the provincial associations.

[4] To date, Meritas has invested $500,000 in "stable, well-run, socially productive institutions, and with carefully chosen community development banks, credit unions and loan funds" (Meritas, 2004). As of the time of this report Aquity had not placed any CI investments.

secondary to the social criteria. Their experience in Canada is such that there are few qualified community investment vehicles that would satisfy their fiduciary responsibilities. Some credit unions, such as VanCity Savings Credit Union, offer modest return term deposits that channel community investments into environmental and social enterprises. One institutional investor has $1 million invested in VanCity's International Community Investment Deposit which provides up to 2% returns (the return is selected by the investor) on investments that support micro-credit programs in third world communities. However, as some of the examples below demonstrate, there is an emerging track record of modestly priced market grade CI in Canada. There is no aggregated data available on financial performance of CI in Canada.

3.2 Canadian CI Examples

3.2.1 Ecotrust Canada

Ecotrust Canada's mission is to support the emergence of a conservation economy in the coastal temperate rainforest region of BC. In 1999 they set up the Natural Capital Fund to provide non-bank, higher risk loans, which today stands at $3.8 million in assets. To date they have provided over 40 loans to entrepreneurs who incorporate socially and environmentally responsible practices in their businesses, including loans to an organic food company, a First Nation-owned sawmill, an employee-owned fish plant, a green office supply company and a botanical garden. Over three-quarters of the loans have been made to businesses on Vancouver Island and altogether these investments have supported about 500 seasonal, part time and full time jobs. They have received over $520,000 in community investments which currently provide a return of 2 – 3% to the investors.

3.2.2 Community Futures Development Association of BC (CFDABC)

Established in 1992, the Community Futures Development Association of BC (CFDABC) represents 33 Community Futures Development Corporations (CFDCs) located throughout rural BC. CFDCs offer a variety of entrepreneurial programs, business counseling, loan programs and business information to community members interested in expanding or starting their own businesses. Since its inception CFDABC has acted as an intermediary for CFDCs, managing over $23 million in debt instruments from an insurance company, a venture capital firm and BC credit unions. These investments have generated returns of 6%, 2 – 3% and prime minus 1 – 1.5% respectively. Using the CFDC job multiplier of 21 businesses financed per $1 million and 326 jobs supported per $1 million (Weicker and Co., 2002, p. 10), the SROI of these investments results in approximately 483 businesses financed and 7,498 jobs supported.

3.2.3 Community Economic Development Investment (CEDIF) Programs

Nova Scotia's CEDIF tax credit program has resulted in the creation of a number of new community investment initiatives:

BCA Investment Co-operative Ltd., based in Sydney, N.S., has a mission to build a better community through creation of rewarding and well-paying jobs, to be accomplished through equity investments in local businesses. Capital raising began in 2000 under the CEDIF program and today the investment co-operative has raised over $1.5 million from nearly 400 shareholders. Key investment sectors include: earth and resource industries, manufacturing, oil and gas, tourism and culture and knowledge-based industries. Investments to date have resulted in creating or saving more than 200 full-time jobs for Cape Bretoners.

The Scotian Windfields funds were also created under the CEDIF regime to generate investments in renewable energy assets, primarily wind power. Established in partnership with Renewable Energy Services Limited, over nine funds are currently in operation, collectively comprising a multi-community network of renewable energy development projects.

3.3 CI Impacts

While there have been few attempts to measure the social and environmental impacts of community investing in Canada, the Community Futures Program in Western Canada determined that every $3,059 of financing supported the creation of one job. Applying this metric to the $69 million in CI results in an estimated 22,556 jobs supported or assisted through community financing vehicles in Canada. Ecotrust Canada has generated a more conservative metric at $10,000 per job, resulting in the support of 6,900 jobs for the $69 million invested. Applying Calvert Foundation's SROI metric in the US[5], of roughly 522 small business jobs supported for every US $1 million five year investment, results in CI's support of 36,018 small business jobs in Canada. While each of these job creation multipliers points to significant job creation benefits, the range of estimates reinforces the need to develop standardized SROIs for the CI industry.

3.4 Economically Targeted Investing in Canada

Because ETIs are investments that fill capital gaps (through predominantly private placement markets) in under-financed areas of the economy while earning risk-adjusted market rates of return, they are considered a community investment for the purpose of this paper. One significant distinction between the CI and ETI fields is that community investments may earn below market returns while ETIs exclude below market investments, consistent with fiduciary obligations. ETIs are largely an American

[5] Calvert Foundation is a US $100 million non-profit foundation with a mission to increase awareness and participation in CI. They have a program called Calvert Community Investment Notes that pay below-market fixed rates of interest to investors seeking to place investments into non-profit intermediaries which service disadvantaged communities and people working their way out of poverty. Launched with the help of the Calvert Group $10 billion socially responsible mutual fund family, Calvert Foundation has been a leader in bringing CI to the broader retail market across the US for almost a decade. Throughout its history it has financed the creation of over 100,000 jobs, 5,000 affordable homes and 6,000 community facilities for low-income communities.

phenomenon, having evolved over the past four decades. They gained traction in the US in the 1990s when regulators made their approval of ETIs official, acknowledging their focus on collateral (social) benefits, and resulting in the entry of major public pension funds into the ETI field. Institutional investors, including pension funds, foundations, mutual funds, religious institutions, insurance companies and the like, pursuing an ETI strategy typically invest in affordable housing and other real estate, technology start-ups, small and micro-business, investments preferring unionized workers, minority and women entrepreneurs, restructuring manufacturers and infrastructure or community development, depending on the social priorities of the investor among other factors. Proponents of ETIs claim they produce a competitive rate of return commensurate with risk while creating collateral economic benefits for a targeted geographic area, group of people, or sector of the economy (Harrigan, 2003, p.241).

There is no accepted definition of ETIs in Canada and no regulatory framework to sanction their existence. Canadian pension funds and other fiduciaries necessarily turn to the US for this justification. Lacking a definition and measurement methodology, there is limited tracking, trend and impact research on ETI investments in Canada. Canadian academics in this field speculate there are at most under 20 ETIs including the seven Labour-Sponsored Investment Funds which have adopted a set of social standards. That said, the ETI asset base is not insignificant once the seven LSIFs ($5.62 billion) and the Caisse de dépôt et placement du Québec ($4.5 billion) assets are factored in, topping roughly $11 billion of known ETI investments in 2002. The federal government, through its Social Sciences and Humanities Research Council (SSHRC) program, has provided a $1 million grant to Ontario Institute for Studies in Education (OISE) of the University of Toronto for a study of "Pension Fund Transformation", including an investigation of ETI in Canada, in an attempt to bridge this research gap.

While there are no comprehensive statistics on ETI impacts, a number of LSIFs maintain records of their employment impacts on investee firms. Independent studies show that these funds have had a dramatic impact on job creation and retention (Perrin, Thorau and Assoc., 1998; SECOR, 1996). Crocus Fund management estimates that the cost for each job they create is on average $23,000, far less than the $40,000 average for most venture capital investment (Hebb and McKenzie, 2001, p. 146). The Crocus Fund has recently launched the $25M Manitoba Property Fund in conjunction with co-investors the Workers Compensation Board and the Teachers' Retirement Allowances Fund. The purpose of the fund is to invest in real estate primarily focused on the historical sector of Winnipeg's downtown.

3.5 ETI Examples

Two additional examples of Canadian ETIs with longer track records include:

3.5.1 Concert Properties

Twenty-one BC-based union and management pension funds pooled $27 million to form Concert Properties in 1989 (originally named VLC) with the objective of financing affordable rental housing in BC, and creating jobs in the unionized construction industry. Today the 100% pension plan owned real estate corporation has $800 million in assets, with a track record of creating 10 million hours of on-site employment for unionized construction workers.

3.5.2 Fondaction

Fondaction pour la coopération et le développement de l'emploi was established in 1966 by la Confédération des syndicats nationaux (CSN), the second largest labour federation in Quebec. While similar to Fonds de Solidarité and other LSIFs, Fondaction has made a particular commitment to investing in the social economy[6] in Quebec.

Filaction (le Fonds pour l'investissement local et l'approvisionnement des fonds communautaires) is a subsidiary of Fondaction with a mandate to finance enterprises in the social economy, including local community and micro-credit funds (loans from $50,000 – $150,000). Notably, Filaction was instrumental in the creation of five regional investment funds for female entrepreneurs in Quebec. Fondaction also created Le Fonds de financement coopératif with a mission to invest between $100,000 and $250,000 in cooperative or non-profit enterprises.

In collaboration with the Fonds d'action québécois pour le développement durable (FAQDD), Fondaction established Le Fonds d'investissement en développement durable (FIDD), which supports businesses developing technologies or products that optimize the use of natural resources or that have a significant impact on the reduction of waste, pollution or energy consumption.

Fondaction participates in a number of different specialty funds, like the Fonds Waskahegen, which aims to create and maintain jobs for non-reserve native peoples, and the Fonds d'emprunt économique communautaire de Québec (FEÉCQ) which supports employment generation projects by marginalized individuals.

On May 31, 2003, the realized or committed economically targeted investments of Fondaction reached $144 million, financing almost 100 businesses and directly or indirectly creating thousands of jobs, generating average annual returns for shareholders of 2.29% (excluding the tax credit).

3.6 Sustainable Venture Capital

As neither the Social Investment Organization in Canada nor the Social Investment Forum in the US track the SVC sector we propose our own definition: Sustainable Venture Capital refers to the sub-sector within the venture capital industry that

[6] The Quebec government defines social economy enterprises as fulfilling the following objectives: (1) financial viability; (2) capacity to create stable employment; (3) responding to social needs; (4) produce goods and services which correspond to unmet needs; and (5) contribute to improving the quality of life of workers in local communities.

proactively invests in social and environmental technologies, processes and enterprises within professionally managed venture capital portfolios. Because of the lack of tracking within the SRI industry, it is impossible to provide figures on the assets allocated to social and environmental venture capital as a sector. Turning to the traditional venture capital field, Macdonald and Associates in their 2003 VC Industry Overview put the Canadian sustainable venture capital sector (specifically energy and environmental technologies) at $45.46 million invested in 2003 (26 companies) compared to VC overall at $1.49 billion and 616 companies. (Cleantech Venture Network (2003, p.3) estimates $78 million in 2003 down from $150 million in 2002.) The statements of interest Sustainable Development Technology Canada[7] (SDTC) receives each funding round provide insights into the status of the SVC market in Canada: in the five funding rounds conducted since April 2002, 806 statements of interest have been received representing $5.2 billion of clean technology project potential. The average project size is $6.4 million; 95 have proceeded to proposal phase and 37 projects have been approved for funding. Should these 37 – 95 projects come to fruition and should they result in the leverage of additional venture financing, this will represent a significant leap forward for the Canadian environmental technology sector.

The Cleantech Venture Network (2003) reports that the clean technology sector has emerged as the sixth largest venture investment category in the US and Canada, behind information technology, software, biotechnology, health care and telecommunications. In 2002 investments in energy-related clean technologies represented nearly half (45.5 per cent) of all clean technology investments. The remaining investments in clean technologies included enabling technologies – technologies developed by biological, computational and physical scientists and engineers that enable better use of natural resources and greatly reduce ecological impact (14 percent); materials and nanotechnology (13.8 percent), materials recovery and recycling (8 percent) and water-related technologies (4 percent). As of the first quarter of 2004, according to the Cleantech Venture Network (2004) the average investment deal size is up in the sector by 15% from the previous year, to just under US $7.1 million per deal, compared to the average investment in venture deals across all industries of US $7.5 million.

According to one industry observer, clean and environmental technologies are not a sector, but an investment theme or category, with applications across all venture capital sectors. He predicts large and highly disruptive market opportunities emerging in the multi-billion dollar agricultural, manufacturing and transportation sectors, as well as in the fundamental enabling areas of energy and water (Parker, 2004). Pension funds and banks are more known for their investments in mainstream venture capital, while primarily high net worth individuals are driving investments in sustainable venture capital.

There are a limited number of community development venture capital (CDVC) funds in Canada, similar to those in the US (for a description of CDVC funds see Appendix A

[7] Sustainable Development Technology Canada (SDTC) is a not-for-profit foundation established by the Government of Canada in 2001 that finances and supports the development of clean technologies. The Foundation draws from an investment fund of $350 million.

Literature Review), and at present no statistics are readily available on this group. SOCARIAQ in Quebec provides an example of a CDVC fund that includes an ETI investor.

3.6.1 SOCARIAQ

SOCARIAQ (Société de Capital de Risque Autochtone du Québec), a $6 million equity investment fund, provides financing to new and existing businesses controlled by members of Quebec First Nations. It is a First Nation controlled non-profit organization governed by five investors including two non-profit Aboriginal Capital Corporations, the Native Benefits Plan Fund, the Mouvement des Caisses Populaires et d'Economie Desjardins and the Fonds de Solidarité, a LSIF. Established in March, 2002, it is projected to invest in 40 businesses during its first five years of operation, with investments expected to range from $75,000 to $500,000 and a target rate of return on investments anticipated between 15 – 20 %.

A significant potential beneficiary of SVC, ETI and Community Investing are Aboriginal businesses. However, for the most part, neither Aboriginal Capital Corporations (ACCs) nor Aboriginal Community Futures Development Corporations (ACFDCs) receive external investments for their loan and equity programs – they are primarily capitalized by the Federal Government. There are a few unaffiliated Aboriginal venture capital corporations in Canada that receive outside market-rate investments, SOCARIAQ being one of them, though there is no comprehensive data on their existence so little is known about them as a sector. Reasons for the lack of external investment into aboriginal finance vehicles are believed to include:

- difficulty in understanding the regulatory framework for financing activities on Indian reserves (e.g. Indian Act and Indian Oil and Gas legislation as well as Indian and Northern Affairs Canada policies that affect land titles, asset registration, security, taxation, zoning, etc.); and
- absence of standard rating for Aboriginal capital instruments.

A study conducted in 2000 for Industry Canada concluded:

Key informants see Aboriginal Financial Institutions (including ACCs and ACFDCs) as being different than the mainstream financial sector. They are smaller in terms of their loan portfolios, with fewer assets in terms and cash. Their clients are distant, more likely to be in remote locations and slightly less credit worthy. AFIs have relatively higher costs and slightly higher net interest on their loan rate. They have a greater percentage of total revenue derived from loan interest and the per cent of their portfolio in developmental loans is more than for a bank. All key informants suggest AFIs fill a gap in the products or services offered to Aboriginal business by the mainstream financial sector (Vodden and Cook, 2002, p. 1).

As AFIs are intended to provide developmental (higher risk) lending to Aboriginal businesses, they would be an ideal candidate for CI programs, save for the significant regulatory, perception and standardization issues mentioned above.

4. DESCRIPTION OF THE US CI SECTOR

4.1 The US CI Sector

As has been noted, the US has the largest community investment sector in the world, at US $14 billion as of 2003, with roughly 800 – 1,000 CDFIs operating domestically. The fastest growing sector of SRI in the US, assets in CDFIs grew 84% from 2001 – 2003, nearly doubling their total assets over this period. Over the past number of years, considerable effort has been generated to track and monitor the community investment sector in the US. The creation of a number of community investment trade organizations has further helped catapult this sector into more mainstream circles with their focus on documenting and standardizing the CI industry.

From their recent studies we learn that financial institutions, including institutional investors such as pension funds, make up the largest source of borrowed capital, shares and deposits for CDFIs, at 42 percent. However, the largest single contributor to CDFIs since 1995 has been the US Department of Treasury providing US $534 million in awards to the sector through three funding programs. Interest rates charged by the sector reportedly range from 5.6% (housing to individuals) to 9.2% (microenterprise). The capital adequacy ratio for reporting CDFIs is 27% equity capital, which, when combined with average loan loss reserves of 5%, is more than sufficient to absorb portfolio and operating losses. (CDFI, 2002, pp. 3, 5, 7)

While their CI impacts go well beyond easily measurable impacts, in 2002, CDFIs in the US are credited with having: provided US $2.6 billion in financing; financed and assisted 7,800 businesses that created or maintained more than 34,000 jobs; facilitated the construction or renovation of more than 34,000 units of affordable housing; built or renovated more than 500 community facilities in economically disadvantaged communities; provided mortgages to 4,100 people and provided more than 4,800 alternatives to payday loans (CDFI, 2003, p.4).

As for performance, CDFI portfolios for the most part, performed well even during the economic slowdown. Overall, net loan loss rates for CDFIs were 0.7% ranging from a total of 0.2% in the community development bank sector to 0.9% in the community development credit union sector; this rivals the net loan loss ratio at conventional financial institutions of 0.97% in 2002 (CDFI, 2003, p.20).

With the multitude of US CDFIs it is difficult to narrow the field down to a few exemplary organizations to profile. The following have been chosen in that they demonstrate some interesting approaches to community investing: environmental enterprise creation; a secondary capital market for community investments; and an environmentally screened mutual fund investing in conservation finance as part of its CI portfolio.

4.1.1 Shorebank and Shorebank Pacific

Shorebank is the first and leading community development and environmental banking corporation in the US, based in Chicago. Since its founding in 1973 ShoreBank has invested more than US $1.7 billion in their priority communities – those traditionally underserved by other banks – and minority owned companies. They have created, retained or placed nearly 11,000 jobs and have rehabilitated 38,000 units of housing, while investing US $305 million in small businesses since their inception (2002 figures).

With 2003 overall consolidated assets of US $1.5 billion ShoreBank also operates a real estate development company, a not-for-profit organization in each of their five priority markets, a consulting company and a mezzanine finance company – all of which support ShoreBank's mission to build strong sustainable communities, protect and restore the environment and help their customers build wealth. ShoreBank offers a full suite of banking products and services in addition to their community investment options.

Over 4,000 individuals, corporations and non-profit organizations have supported ShoreBank's work by placing deposits in ShoreBank's banking subsidiaries _ US $324 million at year end 2002. Called Development Deposits® and EcoDeposits®, these investments offer the same features and market rates as other bank deposits and are equally federally insured. The bank converts these ordinary bank deposits into development loans in support of the bank's overall community and sustainable development objectives.

While Development Deposits® help to finance economic activity in underserved communities, EcoDeposits® offer community investors the opportunity of supporting the work of ShoreBank Pacific, the first regulated financial institution in North America dedicated to sustainability-based economic revitalization, based in Washington State. ShoreBank Pacific works to fulfill its mission to create a conservation economy in the rainforest of the Pacific Northwest by targeting its lending to local companies that use energy efficiently, work to reduce waste and pollution and conserve natural resources. In 2002, EcoDeposits® attracted US $57 million in deposits, US $81.4 million by June 2004, representing 2,073 investors with an average investment of roughly US $40,000.

ShoreBank Pacific lent out US $12 million in 2002, and across the group, ShoreBank financed a total of US $56 million in conservations loans for hundreds of conservation projects. Borrowers have used the proceeds to conserve energy, reduce negative environmental impact, produce "green" products and market to "green" consumers, significantly extend the useful life of old buildings and restore abandoned buildings to productive use. Their Pacific companies focus on organic farming, environmentally responsible fishing, non-timber forest products, redeveloping contaminated sites and financing green buildings. Over the past year their financing helped support 1,378 full time and over 2,000 seasonal jobs. Since inception they have helped put 535 acres of crop under organic production.

4.1.2 Community Reinvestment Act (CRA) Qualified Investment Fund

The CRA Qualified Investment Fund is a mutual fund devoted exclusively to community investment. As of August 2004, 250 institutional investors with US $1.6 trillion in combined assets have invested in the fund to date. Current assets stand at US $475 million. The fund has recently been made available to individual investors through Charles Schwab, a no-load, no-transaction fee service with a minimum investment of $2,500. Since its inception five years ago, the CRA Fund has generated annualized returns of 6.27% (July 2004), placing it in the top 20 percent amongst 79 funds in its category. Named after the federal Community Reinvestment Act of 1977[8], the fund seeks to provide equal access to credit and capital for low- and moderate-income families, who are typically underserved by mainstream financial institutions. Over the past five years the Fund has directed nearly US $900 million to community development, supporting the generation of 61,515 affordable rental housing units, 2,159 homes for low- to moderate-income families and 1,285 affordable health care beds. A recent example of a bond purchase is the St. Vincent de Paul Society in Seattle. The purchase assisted the charity to expand both its network of six thrift stores and its mattress factory which is helping to create jobs for low income residents.

4.1.3 Portfolio 21

Portfolio 21 is a US $51 million global growth stock mutual fund for individuals and institutions, with a mandate to invest in companies with demonstrated leadership in sustainable business practices. Investee companies are those that have made an explicit commitment to sustainable business practices and allocated significant resources to achieve its goals. Companies are scored against criteria tailored to their industry group and are compared with their competition in such areas as the lifecycle impacts of their products and services, relationships with suppliers, investments in sustainable technologies and processes, leadership, resource efficiency, and environmental management. Portfolio 21 looks most closely at earnings improvements derived from ecologically superior product lines, efficient use and reuse of resources, investments in renewable energy, innovative transportation and distribution strategies and fair and efficient use of resources with respect to meeting human needs. Portfolio 21 has committed to invest one percent or more of the fund's value in community investments, totaling nearly $500,000 in summer 2004. Shorebank Pacific is included among their three community investments because of its commitment to The Natural Step[9]. Portfolio

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[8] Enacted because formal financial institutions were closing down branches in low-income areas, the "CRA and its implementing regulations require federal financial institution regulators to assess the record of each bank and thrift in helping to fulfill their obligations to the community and to consider that record in evaluating applications for charters or for approval of bank mergers, acquisitions and branch openings. The law provides a framework for depository institutions and community organizations to work together to promote the availability of credit and other banking services to underserved communities."(SIO & Riverdale, 2003, p.11).

[9] The Natural Step is a science and systems-based approach to organizational planning for sustainability. www.naturalstep.ca

21 is currently posting 5-year returns of 2.29% against the MSCI World Equity Index benchmark of -1.08%.

4.2 Economically Targeted Investing in the US

As with Canada, there is no comprehensive tracking of ETI investments in the US, making it difficult to gauge the size and growth of ETI activity on the part of pension funds and other institutional investors. A 1995 report estimated the combined assets invested in ETI programs in public pension plans at 2.4 percent of the total, roughly US $55 billion. At that time, there were at least 29 states in which public pension plans had some form of ETI program (Hoffer, 2004a), the most common being residential housing (32%) and venture capital (25%) (Hoffer, 2004b). Eight-four percent of all ETI funds (over a decade ago when these figures were compiled) were invested in residential housing and other real estate, with 3% in venture capital and .2% in small business loans (Hoffer, 2004b). According to the Social Investment Forum, several public pension plans are required by their Board of Trustees or Department of Fiscal Services to commit to an investment goal of five to ten percent in ETIs (SIF, 2003, p. 27). These investments are made possible, in part, due to a variety of government risk management and subsidy programs, thereby providing opportunities for market rates of return for pension fiduciaries.

As ETI impact data is scarce one needs to look at the track record of existing ETI programs to better understand the potential of ETI to yield sustainability benefits. The California Public Employees' Retirement System has one of the largest, most comprehensive, ETI programs in the US.

4.2.1 California Public Employees' Retirement System (CalPERS)

CalPERS is the largest public pension fund in the US with assets of US $167 billion. In 2000 it launched the Double Bottom Line initiative (Office of the Treasurer, 2004a) targeting investments in urban neighbourhoods, to generate market returns for the fund and spur economic development in California communities. Since then more than US $9 billion has been directed into these communities, from equity investments in urban businesses to mortgages for working Californians in urban and rural neighbourhoods. Approximately 13 percent of the Pooled Money Investment Account (PMIA) is now in California "double bottom line" investments. As of March 2004 the PMIA has:

- Invested over US $1.7 billion in home loans to low- and moderate-income individuals and neighbourhoods – currently yielding more than 5.87% annually;
- Invested US $537 million in small business loans – these loans have yielded from 1.3% to more than 7% annually;
- Yielded returns of 1.04% on its US $5.8 billion to community lending institutions and credit unions, many serving inner city and rural areas. This is an increase from US $1.9 billion in deposits in 1999 with typically .03 to .1% higher yields than comparable Treasury securities in which these funds otherwise may be placed; and

- Earned an annualized return of 10.3% since 1966 on its California Urban Investment Partnership, part of the commitment to inner city real estate development. CalPERS' original investment of US $50 million in this program has increased to US $290 million.

Additionally, CalPERS has adopted a goal of investing 2% (approximately US $3.3 billion) of its portfolio in domestic emerging markets, primarily in California. Under the "California Initiative" it has committed over US $1.3 billion to urban, in-fill real estate ventures, including US $150 million for affordable housing and US $475 million for private equity investment in businesses in underserved areas. According to CalPERS, "underserved markets" are urban and rural areas with limited access to needed goods and services. Underserved markets offer companies untapped assets, such as large labour pools, low real estate costs and underutilized infrastructure (Harrigan, 2003, p.245). CalPERS' US $20 billion investment in California is estimated to have created more than 54,000 jobs (Harrigan, 2003, p.251).

Last Spring CalPERS launched its Environmental Technology Investment Program (Office of the Treasurer, 2004b) with a commitment to invest up to US $200 million in the environmental technology sector over the next few years, making private equity investments, venture capital and project financing available. It will target investments in environmental technology solutions that are more efficient and less polluting than existing technologies such as recycling; minimize the use of natural resources; and reduce emissions, refuse and contamination to air, water and land. The program will be managed under the Alternative Management Investment (AIM) Program, which has committed more than US $19 billion to private equity investments.

4.2.2 United Methodist Church General Board of Pensions and Health Benefits (General Board)

The General Board, one of the nation's hundred largest pension funds, has a dedicated investment manager of affordable housing and community development. They are the largest institutional investor in affordable housing and community development with nearly US $1.6 billion in CI investments. As with all General Board investments, CIs are designed to earn a market rate of return commensurate with risk to participants while supporting underserved communities and the development of affordable housing.

4.3 Sustainable Venture Capital in the US

Comprehensive data on the SVC sector in the US is not readily available, particularly using the definition of this paper, which includes venture capital invested for both social and/or environmental returns. Turning to the Social Investment Forum's 2003 SRI Trends Report, data is available for Community Development Venture Capital funds which use the tools of venture capital to create jobs, entrepreneurial capacity and wealth, thus improving the livelihoods of low-income individuals and the economies of distressed communities. "With US $485 million of capital under management [a 58% increase over 2001] CDVC funds make equity and equity-like investments in small businesses that hold the promise of rapid growth. Investments typically range from $100,000 to $1 million per company, smaller than most traditional venture capital investments. The companies in which CDVC funds invest generally employ between 10 and 100 people" (SIF, 2003). For CDVCs, most funds are still too young for a definitive assessment of the financial returns, but preliminary results for some of the older funds show gross internal rates of return between 8% and 17% (CDFI, 2003, p.38).

Cleantech Venture Network provides statistics on the "environmental" venture capital sector in the US. They report that in the US, overall venture activity declined by 14% from 2002 to 2003, while 'cleantech' increased 8% over this period from US $1.1 to $1.2 billion, with investments financing 179 clean technology companies in this period. As a result, 'cleantech' grew in relative terms from 5.1% of total venture investments in 2002 to 6.4% last year.

These statistics for both environmental and social venture capital suggest that the SVC sector is growing year over year, with corresponding benefits for the environment and society. Pacific Community Ventures, a CDVC Fund with a strong social mission, provides insights into how community development SVC vehicles are structured in the US.

4.3.1 Pacific Community Ventures

Pacific Community Ventures (PCV) is a non-profit organization, based in California, which manages 2 funds from which it makes equity investments in selected businesses. The purpose of these investment funds is to attract and channel institutional investment dollars into private companies that provide good jobs with marketable skills, benefits, wealth creation vehicles (e.g. stock option and profit sharing plans) and job training in low income communities. CalPERS and Citigroup (one of the world's largest financial services companies) are two such institutional investors. With current assets of US $18.5 million, PCV has invested US $8 million in seven companies to date.

Over nearly four years PCV-financed portfolio companies have employed a cumulative total of 850 employees from low income communities, and paid average wages of US $11.59 per hour well above California's living hourly wage of US $10.25.

4.4 Analysis and Implications for the Canadian CI Industry

Even taking into account the difference in population between the two countries, the Canadian CI sector – including the ETI and SVC fields – lags the American experience by a wide margin. Clearly there are a number of conditions in the US which have given rise to this disparity. Most attribute the growth of the CI sector in the US to a combination of the following:

- Government programs – federal and state governments have developed a comprehensive array of government risk management, tax incentives and other subsidy programs.

- Government regulation – 1995 revisions to CRA which recognized CDFI investments as qualified CRA activity and 1995 ERISA regulations permitting pension fund ETI activity.
- Track record – CDFIs have established a successful track record of making effective and prudent use of capital to serve economically disadvantaged markets.
- National trade associations and intermediaries – the recent emergence of national trade associations and intermediaries to organize and develop the industry have played a key role especially in the standardization of the CI industry and the creation of secondary markets.
- CDFI growth – more institutions than in the past result in a greater number of investment opportunities for retail and institutional investors.
- Increased awareness – the 1% campaign of the Social Investment Forum has generated over US $ 1 billion in assets towards CI since its inception in 2001 (SIF, 2003, p. 29). The SIF campaign includes a website, how to manuals and other initiatives to help promote CI to fund managers and also address their needs for qualified CI investments.
- Lousy market – some CI fund managers suggest that poor returns in the equity market have prompted investors to move out of equities and into fixed income options. For many their CI portfolio had solid returns relative to other asset classes for the past number of years. Indeed, fund managers find that when there is nothing positive to tell their clients about financial returns (ROI) they are happy to report out on their *SROI*.

More statistics in the case of SVC and more current statistics in the case of ETI programs are needed before a comprehensive comparison can be made between the two countries in respect of these fields. However, this brief exploration draws one to conclude that the US CI market has made considerable gains in the past number of years and is well poised for growth. There is significantly more funding available in the US from investors, the banking industry, government and donors to help fuel this expansion. Indeed, industry observers (Ellman, 2004) suggest that the growth in the US CI sector is a direct result of the Community Reinvestment Act, the CRA Qualified Investment Fund and the federally-funded CDFI Fund[10]. All of these programs have their roots in the civil rights struggles of the 1970s and 1980s in which local communities fought for federal mechanisms to rebalance local economic inequities (referred to as bank redlining). These early victories have now led to the capital transfusion from the private sector (via the banks through the CRA and from the investment community through CRAQIF) and the federal government through the CDFI Fund. Canada, on the other hand, lacks a strong government role, banking presence in CI, investor awareness and a significant donor base limiting its ability to capitalize on the lessons that can be learned from the US CI sector. (It is interesting to speculate, for example, on how a fraction of the five big banks' $128

[10] The Community Development Banking and Financial Institutions Act, enacted in 1994, led to the creation of the Community Development Financial Institutions Fund. This fund, housed within the US Treasury Department, supports community investment funds through equity investments, capital grants, loans and technical assistance support (SIO & Riverdale, 2003, p.11)

million in Canadian charitable donations could boost the fortunes of Canadian CI.) More will be said on this topic in the barriers and opportunities section.

5. INVESTMENT ALLOCATION ISSUES

The success of the American 1% campaign which saw 54 SIF member institutions, including investment managers, advisers, brokers and mutual fund companies invest over US $1 billion in CI, with an average investment of US $15.7 million (SIF, 2003, p. 29) points to the significant role fund managers can play in targeting CI financing. In Canada there may be 20 fund managers channeling CI financing in this way, if one includes ETI financing and excludes the SVC sector for which there is limited Canadian data. The following is an introductory assessment of some of the fiduciary and capital allocation issues fund managers confront when considering CI investing.

5.1 Fiduciary Issues

As noted by Gil Yaron – one of Canada's leading experts in interpreting pension fund legislation as it relates to socially responsible investing – trustee fiduciary duties arise from common law and are codified to an extent in federal and provincial pension and trustee legislation (Yaron, 2001, p. 4). Trustees' duties and investment decisions are governed first by the trust instrument wherein trustees are bound to follow specific criteria for asset investment as set out in the trust instrument. Accordingly, "if the trust provides instructions to consider non-financial criteria [...] then the trustee may follow the terms of the trust without fear of being in breach." (Yaron, 2001, p. 4) When the trust instrument does not provide investment management direction, the following provides guidance:

- Duty of prudence: to act with the care, skill and diligence of a prudent person in managing the assets of another.
- Duty of loyalty: to act in good faith and in the best interests of […] beneficiaries treating all with an even hand.
- Duty to diversify the portfolio.
- Duty to avoid conflicts of interest (Yaron, 2001).

In the case of pension trustees deciding to consider ETIs as part of the pension plan's investment strategy Yaron and Kodar (2003, p.93) recommend their investment policy include, for example:

- The types of investments of interest to plan members
- The percentage of assets to be allocated to such investments and the plan's overall risk/return profile
- A provision restating the fiduciary duties of trustees, including reference to avoiding conflicts of interest
- A requirement that trustees obtain expert legal and investment advice in considering ETIs
- A mechanism for independent arms-length valuation of such investments

- An assessment of performance of such investments against comparative benchmarks where available.

The US Department of Labour (see footnote 24) requires that pension funds investing in ETIs must ensure that expected ETI returns are commensurate with similar types of investments with similar risk profiles (Yaron & Kodar, 2003, p. 91). The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally (ERISA Interpretive bulletin, 1974).

This is admittedly a very superficial treatment of fiduciary matters, but hopefully it serves to highlight the fiduciary responsibilities of trustees and their fund managers considering investments that generate social in addition to financial returns. Indeed, practicing Canadian and US CI fund managers report that they adopt very prudent guidelines in selecting their CI investments, as the discussion on capital allocation issues below reveals.

5.2 Capital Allocation Issues

For the purposes of this review five US and Canadian managers were interviewed to understand the typical capital allocation decisions they execute in the fulfillment of their social objectives and fiduciary responsibilities[11]. Together with web and other research conducted on this question, their experience points to the following capital allocation considerations:

1) Fund Objectives – in every instance institutional investors publicly disclose their commitments to invest in CI, whether for social and/or environmental returns. They may be guided by one of two different motivations – to provide capital to the community and generate a return to the fund; or not to generate financial returns but simply to provide capital to the community without the loss of principal.

2) Social Policy/Client Guidelines – fund investment policies and client guidelines typically set out the funds' approach to the following social considerations:

- Geography, target groups, social record and social/environmental impact of fund; capital deployed (funds look for CI vehicles with significant capital deployed to maximize social impact)
- Asset allocation targets of 1, 2 or 3% (or client driven up to 100%) with no known rules of thumb, save for the modest allocation to limit financial impact on overall portfolio
- Equity or debt and type of institution as determined by policy

3) Risk – all fund managers report applying the same standard of care as for their other investments:

- Look for risk-share provisions, limited or principal guarantees and insurance back-ups provided by governments or other donors
- Use of CI intermediary who performs underwriting authority and delegated servicing

[11] All five fund managers were invested in CI debt instruments; the survey does not include the views of CI equity investors. See Appendix B for a list of interviewees.

- Investment limits – assets are arrayed across a diversified group of intermediaries with no intermediary originating over (e.g.) 20% of program assets; no individual CI should be more than (e.g.) 10% of the total CI pool
- Ability to repay – CI investors are seeking investment quality – A or higher rating – or have an insurance back-up; they assess the caliber of management
- Co-invest with other institutions
- Look for local comparable benchmark (e.g. local bank term deposit rates) or benchmark CI investments to other comparable indexes
- US mutual funds require that all investments be priced daily, so require same of their CI investments

4) Rate – investors are seeking reasonable, not maximum, rates of return, at or near market, depending on the fund guidelines. Some look for inflation-protected rates of return and others speak to market rates of return commensurate with risk and risk-adjusted rates of return. Depending on investment guidelines some funds manage their CI investments such that returns before fees on the overall fund are approximate to their fund benchmark and in this fashion are satisfied with CI investments that may generate near market rates of return[1].

Some funds, such as the Canadian Acuity Social Values Global Equity Fund, include in their prospectus a very conservative outlook on the performance of their CI investments, with the expectation that their CI investments will underperform the market. Their prospectus define CIs thus: "CIs offer a rate of return below the then-prevailing market rate, and are considered illiquid, unrated and below-investment grade. They also involve a greater risk of default or price decline than investment grade securities." (Acuity, 2003, p. 29). Not all investors would define their CI investments in this way, demonstrating the diversity in approaches to, and expectations for, community investing on the part of practicing CI fund managers.

It is also interesting to note that some Canadian funds are having difficulty finding qualified Canadian investments that meet their capital allocation criteria, a factor that may result in Canadian use of qualified American CI intermediaries with the resulting loss to the Canadian CI sector.

6. BARRIERS AND OPPORTUNITIES TO GROWING THE CI SECTOR IN CANADA

When compared to the burgeoning CI sector in the US, Canada's CI sector is comparatively weak, once LSIFs and the CDP are factored out of the ETI equation. Previous analysis points to some of the critical drivers underpinning the growth of the American CI industry. Additionally, the foregoing review of capital allocation and fiduciary issues points to critical infrastructure that needs to be in place for the successful development of a strong CI sector contributing significantly to sustainable development in Canadian communities. The following puts these thoughts together as "barriers and opportunities" to the growth of community investment, including ETI programming and sustainable venture capital.

6.1 CI Barriers

- Lack of capacity – community investment funds in Canada for the most part are not only undercapitalized, but struggle for lack of consistent operating support. Mostly small funds, they are under-skilled with a modest track record and a limited regional focus. They lack reporting infrastructure and customer service capacity and are not in a position to deal with the due diligence demands of institutional investors.
- Tax and regulatory barriers – most CI investments are not RRSP eligible; CI vehicles structured as charities are constrained in their investment activities; and the lack of a regulatory regime in Canada mitigate against the community investment sector.
- Challenges in conducting due diligence:
    - A lack of standards – there are no standardized assessment procedures for qualifying credit worthy sustainable impact investments; each CI fund has a different, non-standardized methodology, program and approach.
    - Small transactions/small deal size result in higher transaction costs – products that require special handling result in slow adoption. Investors also lack the skills to conduct due diligence. The cost of due diligence is prohibitive.
    - Pricing – there are no standard comparisons against which Canadian CI can benchmark, no established benchmarks for fiduciaries and nothing that is perfectly comparable. This results in uncertainties regarding how to price CI products.
- Lack of a compensation scheme for financial advisors – broker/dealers perceive the lack of fees and commissions for CI sales as a barrier and, as a consequence, there are few sales and compensation agreements executed between broker/dealer firms and sources of community investment products. One notable exception is the Calvert Foundation which has 25 sales agreements in place with broker/dealers.
- Lack of product knowledge – it is difficult for the CI investor to find CI opportunities. There is no database and no CI investment network for the motivated investor. Additionally the prevailing belief is that all CI investments are concessionary and high risk.

6.2 ETI Barriers

- Lack of pension fund awareness and trustee education
    - Lack of knowledge about this type of investing in Canada
    - Misinformation about ETI characteristics and their permissibility. The general belief is that they are illegal and concessionary and too time-consuming and costly to administer
- Lack of vehicles and expertise to deliver products; competent ETI managers are unavailable
- Lack of performance benchmarks
- Lack of a track record in Canada

6.3 SVC Investment Barriers

- Generic barriers to growing venture capital
- SVC is not seen as a viable investment category by institutional investors
- Lack of expertise, skills and understanding on both 'sides' of green VC investment
- Start-up stage of financing too high risk for most investors
- Perceived political risk with respect to predicting the fortunes of government subsidies to the environmental technology sector
- Few community development venture capital funds in Canada

6.4 CI Opportunities

- Government support programs – modeled after US federal and state programs, Canadian governments could proactively invest in strengthening the core capacity of the sector to better position it to receive private financing. The Federal Government has made a start with its 2004 Budget, by committing $162 million over five years to help establish regional patient capital funds for organizations producing goods and services on a not for profit basis with surpluses going to social or community goals[12]. Additional commitments within this envelope include promoting other sources of lending to benefit these organizations, build capacity and undertake research.
- Favourable tax and regulatory scheme – following the lead of Nova Scotia with its community investment regulations, other governments can follow suit. Community investments could qualify for RRSP tax credits, and the federal government could explore the potential of a CRA or other framework to increase the role of Canadian banks in financing and supporting community economic development.
- National network and intermediaries – a network and other intermediaries could assist the sector to further develop the infrastructure to receive community investments, including rating systems for CI funds, benchmarks, standards, staff training, best practice and other 'how to' information, etc. Financial intermediaries could deal with due diligence issues and help raise private capital.
- Education and awareness for retail and institutional investors – the Canadian SRI industry could launch a campaign to promote community investing, putting in place similar tools as those developed for the US SRI industry, including 'how to' manuals, data base on product availability, supporting data on strength and track record of community investments, resources on how to manage fiduciary issues and how to diversify and price risk, etc.

6.5 ETI Opportunities

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[12] The Federal Government defines the social economy as organizations producing goods and services on a not-for-profit basis with surpluses going to social or community goals. http://www.fin.gc.ca/budget04/pamph/pacome.htm See Glossary for the Quebec government's definition of the social economy.

- Permissive legislative framework, similar to the US
- Legislation requiring pension fund disclosure regarding their social and environmental policies
- Fund-of-funds that intermediate cost-effectively between institutional investors and external managers and provide due diligence expertise
- Creation of private placement returns databases, performance assessment and measurement tools
- Education for pension managers and trustees (Falconer, 1999; Falconer, 2002)

6.6 SVC Investment Opportunities

- Education and awareness for institutional investors including success stories that demonstrate the availability of deal exits and draw attention and capital.
- Legislation requiring pension fund disclosure regarding their social and environmental policies.
- Awareness of the community development venture capital model as an alternative to debt financing programs for the community economic development sector.

This is a simple canvass of the barriers and opportunities to growing the CI sector in Canada, including ETI and SVC investing. However, they point the way to potential strategies for industry representatives, governments, investors and others seeking to generate double and triple bottom line investment opportunities and the sustainability benefits they create.

7. CONCLUSION

It can be quite daunting to consider the list of barriers and opportunities to growing the community, economically targeted and sustainable venture capital investing sectors. No doubt the field looks similar to the emergence of the banking sector in its early days – haphazard development, lack of standards, benchmarks, guarantees and other elements of a soundly functioning financial system. Looked at from this perspective, and looked at from the vantage point of the US community investing sector, the prospects for the growth of the Canadian CI sector seem more promising. As this study shows, some critical supports are needed before CI can fulfill its promise of generating high impact benefits to under-invested communities, regions and sectors in Canada along with acceptable returns to investors.

Essentially this high-level scan points to the following general conclusions about the CI, SVC and ETI sectors in Canada:

1. All three sectors are thought to be very small in Canada, once the Quebec and LSIF funds are factored out of the ETI equation. As a group and even singly these sectors are not well studied and little data exists to fully quantify their scope, scale and impact. As CI is a relative newcomer on the SRI scene, significant knowledge gaps remain.

2. The SVC sector is experiencing some growth in both Canada and the US; the SVC sector in the US, particularly, is growing exponentially. (Canada's growth is more anticipatory, with the emergence of SDTC on the scene.)
3. It seems evident that in the US as in Canada (with the LSIFs), where there is a legal structure and government support, ETIs represent an effective strategy for job and wealth generation.
4. The Aboriginal finance sector in Canada is poised to take off, once these investment opportunities are better understood. Further research into the capital gap faced by Aboriginal communities and what it would take to close this gap could facilitate their integration into the economic mainstream.
5. The scale of the community investment sector in the US is largely attributable to strong federal government support both legislatively and financially (including the much heralded CRA), the existence of a secondary capital market for CI with risk-adjusted market rates of return and the recent SIF awareness campaign. These government and industry programs have resulted in a proliferation of CI vehicles, intermediaries and investment opportunities. Industry networks and trade associations have further helped to scale up the field.
6. Canada lacks a strong federal government role, unlike that of the US. Largely absent from the Canadian scene are regulatory frameworks, tax incentives, risk mitigation and credit enhancement programs, programs that induce the banking sector to support community economic development and capital and operating support to shore up the capacity of the sector. Were these to be in place the Canadian CI sector would likely follow the American lead, developing into an increasingly credible and viable sub-sector of the SRI industry and of mainstream finance. The Federal Government's recent social economy initiative – while limited in its scope compared to the broader approach of this paper – could well have positive long term implications for the CI sector in Canada.
7. That US investors have opportunities available to them for market, near market and below market returns, depending on the degree of social and environmental impact sought and other fiduciary constraints, suggests that the Canadian CI sector can similarly grow to provide a range of investment opportunities for fiduciaries and others. Further standardization of the CI industry in Canada – achievable only through increased capacity funding – would foster the sector's growth, as would investor and public education awareness programs.
8. The recent discourse on blended returns, SROI, social capital markets and the social economy points to increasing practitioner, academic and government interest in gauging the potential of community investing through capital markets to lever sustainability benefits to communities. Further research on this emerging field would accelerate the creation of a viable social capital market in Canada.

Capital market watchers will know that there is growing discontent and cynicism with mainstream capital markets which are seen by some as disconnected from such basic public values as social and environmental responsibility. Within this discontented investment community there is a growing network of private investors looking for blended returns – looking for a role for their investment dollars to lever sustainability benefits. Mixed in with this group are inheritors and self-made wealthy adults who are willing to take the risks called for in this fledgling Canadian industry. They and other institutional investors who can see the double bottom line benefits for their clientele need government and industry leadership to address the barriers and take advantage of the opportunities in order to strengthen the potential of the Canadian social capital market. This is the vision of community investment – the commitment of diverse participants to bridge the capital gaps in the economy towards the advancement of social and environmental quality of life for Canadians.

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APPENDIX A – LITERATURE REVIEW

The following is a brief synopsis of the literature on community, economically targeted and sustainable venture capital investing in Canada and the US. It is worth noting that as this is a niche and emerging investment field in both countries there is a dearth of comprehensive, analytical and data driven literature available for review. In Canada, particularly, the literature on issues faced by the community investment sector is scarce. Industry association sponsored trends reports and community economic development (CED)[1] financing issue analysis make up the bulk of the Canadian literature on CI.

i. Community Investing

While relatively few assets are attributed to the sector, CI is a growing field of investment activity. The US has the largest market for community investment in the world, with an estimated US$14 billion in this asset class according to 2003 figures of the Social Investment Forum (SIF) – expanded by 84 percent since 2001 (US$7.6 billion). While different definitions limit the ability to make firm comparisons, Canada's Social Investment Organization (SIO) has estimated roughly $69 million in this asset class in Canada for 2002 down from $85 million in 2000 ($15 million of the drop attributed to the windup of a single community investment provider).

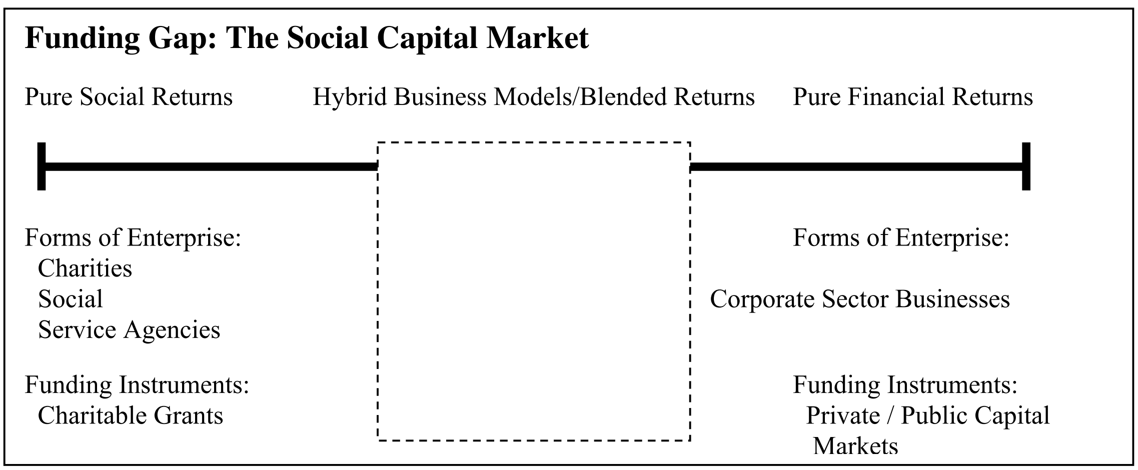
The range of community investment vehicles and methods is growing. Again, the US leads the way with the greatest array of investment vehicles, called Community Development Financial Institutions (CDFIs)[2]. Estimated at 800 – 1000 across the US, this compares to Canada's 50 or so community investment funds identified to date. The investment risk depends on the product, with some fully guaranteed and others not. Risk is managed through a combination of adequate equity capital and loan loss reserves, close monitoring of portfolios, and the provision of technical assistance when needed. Rates vary as well, with some CI products offering market returns, and the majority providing near or below market returns to investors. Access to below-market-rate capital and operating subsidies from governments and private donors are a vital part of CI both in Canada and the US (SIF, 2003; Mendell et al., 2000; SIO and Riverdale, 2003).

[1] The Canadian CED Network defines CED as action by people locally to create economic opportunities and enhance social conditions in their communities on a sustainable and inclusive basis, particularly with those who are most disadvantaged.

[2] CDFI is the US expression used to describe institutions that provide financial products and services to economically disadvantaged people and communities. The CI sector in the US is broken into four CDFI sectors, characterized by their different business models and legal structures: community development banks; community development credit unions (CDCUs); community development loan funds (CDLFs) and community development venture capital funds (CDVCs). (CDFI, 2003). It is important to note that we do not have the equivalent of community development banks in Canda, and at most a handful of CDCUs.

The three streams of support critical to the development of CED in Canada according to the literature include: (1) organizational funding; (2) human capital development; and (3) access to financial capital.[3] While lack of skills and capacity problems are cited as secondary limitations to the development of CED in Canada, the most significant limitation is inconsistent and inadequate financial backing, especially patient capital and governmental support (CCEDNet, 2003 p.12).

Community investment vehicles have been placed between two traditional silos: philanthropy and capital market equity – also between traditional private, non profit and public sector splits (Davis, 2003, p.13; SCP, 2003; Emerson, 2004). Traditional financing focuses entirely on financial returns while charitable financing seeks social returns. This leaves a gap in community financing as illustrated in the following figure:



Funding Gap: The Social Capital Market

Source: Social Capital Partners, 2003

This position in the financial marketplace – the home of community and social investment which generate both financial and social returns – is referred to as the "Social Capital Market". The gap is a measure of the lack of traditional and non-traditional financing available to support the growth of social and environmental enterprises. In the US which has a more developed social capital market, double bottom line loans account for 97 percent of CDFI financing activity, although new equity, near-equity[4] and guarantees are growing segments in the industry, with 94 percent of all equity investment made by VC funds (CDFI, 2003 p.4 & 19). Current legal and normative structures and institutions for capital markets inhibit the growth of CI (Mendell *et. al*, 2000b).

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[3] All recommendations by CCEDNet are to be taken in tandem with complementary and supporting recommendations in the CCEDNet trilogy: *Human Capital Development in Canada: Closing the Gaps* (2003); *Development of Federal Tax Credits to Support Community Investment in Canada* (2003), and *CED Funding and Delivery in Canada* (2003).

[4] Debt-with-equity-features are loans that allow the CDFI to receive additional payments based on the performance of the borrower's company. They include convertible debt, debt with warrants, participation agreements, royalties and others (CDFI, 2003, p.19).

In the US, government legislation and programming have been key drivers of the community investment industry. The Community Reinvestment Act (CRA)[5] and Community Development Banking and Financial Institutions Act[6] have facilitated the creation of a more buoyant social capital market through targeted tax incentives and mandated investment by the US banking sector. Complementary programs include the Low Income Housing Tax Credit (LIHTC)[7]; New Market Tax Credit (NMTC)[8]; Bank Enterprise Award (BEA) Program[9]; Community Development Municipal Bonds (CDMB)[10]; Equity Equivalent Investments (EQ2)[11]; Community Development Corporations (CDCs); Community Investor Pools[12] and Trade Associations (CDFI, 2003; SIF 2003; SIO and Riverdale 2003; Davis, 2003, p.14). In addition, in 2000, the SIF launched the "1% in Community Campaign" aiming to increase assets devoted to CI by encouraging all social investors – including institutional social investors – to shift one percent of their investment dollars into CI. Much of the success of this campaign –

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[5] Enacted in 1977 because formal financial institutions were closing down branches in low-income areas, the "CRA and its implementing regulations require federal financial institution regulators to assess the record of each bank and thrift in helping to fulfill their obligations to the community and to consider that record in evaluating applications for charters or for approval of bank mergers, acquisitions and branch openings. The law provides a framework for depository institutions and community organizations to work together to promote the availability of credit and other banking services to underserved communities."(SIO & Riverdale, 2003, p.11).

[6] The Community Development Banking and Financial Institutions Act, enacted in 1994, lead to the creation of the Community Development Financial Institutions Fund which supports community investment funds through equity investments, capital grants, loans and technical assistance support (SIO & Riverdale, 2003, p.11).

[7] Enacted in 1986, the LIHTC program gives investors a credit against their federal taxes in exchange for providing funds to build or renovate housing at rents within reach of low-income people (SIF, 2003, p.27).

[8] Approved as part of the Community Renewal Tax Relief Act of 2000 to encourage new private capital in CDFIs, individuals and corporate investors can receive an NMTC worth more than 30 percent of the amount invested over the life of the credit in present value terms (SIF, 2003, p.27).

[9] The BEA provides financial incentives to banks and thrifts to invest in CDFIs and support other community development finance work (CDFI, 2003, p.9).

[10] CDMBs are securities issued by the states, cities, towns, counties and special districts that have community development as their primary purpose and the interest on them is generally exempt from federal income tax, and in some cases also from state income tax (SIF, 2003, p.27-28).

[11] Initiated in 1996 by the National Community Capital Association and Citibank, EQ2s are loans to CDFIs that are deeply subordinated, and have a rolling term and other features that allow them to work like equity. These investments provide banks with enhanced CRA credit (SIF, 2003, p.28).

[12] Non-profit Community Investor Pools offer registered investment products, portfolio diversification, and professional management.

which has witnessed more than 30 percent growth between 2001 and 2002[13] of the CI sector since its launch – has been attributed to the argument that the overall negative impact on investor returns is minimal if not absent while the social returns are seen as significant (see Appendix A for an example of fund performance impact). (SIF 2003, p.26)

Canada lacks a broad framework of national legislation and government programming to encourage community investment activities although a number of provincial initiatives aimed at raising equity for certain business sectors, disadvantaged regions and small businesses do exist (Davis, 2003). These include a fixed loan loss reserve supported by the regional development agency Western Diversification; Nova Scotia Equity Tax Credit and the Nova Scotia Community Economic Development Investment Funds[14]; Manitoba Grow Bonds[15], and Manitoba Community Enterprise Development Tax Credit[16] (Davis, 2003). Other complementary initiatives include a formalized community credit network in Quebec; informal micro-credit networks in the Atlantic provinces and in British Colombia, a formal association of aboriginal financial institutions; Community Futures

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[13] The SIF recorded $750 million in CI among institutions giving one percent or more to CI in 2001, and over $250 million in additional assets in CI from institutional investors by the end of 2002.

[14] Nova Scotia has two tax credit initiatives targeted at raising private investment in community initiatives:

1) The Nova Scotia Equity Tax Credit (1994) gives investors a non-refundable provincial tax benefit of 30% of the amount invested to a maximum credit of $9,000 that can be carried back three years and forwarded seven years. A number of criteria apply for eligible issues of shares, for more on these see www.gov.ns.ca/econ/cedif. From 1994 to 2001, a total of $49.4 million was invested by 4,030 investors into 439 companies. These investors received personal tax credits of $14.1 million. With an assumed survival rate (close to the actual) of 75% for businesses, the cumulative net benefit to government from the tax credit is $6,889,000. This includes employment benefits, household income, and provincial government revenue (Davis, 2003 p.16-17).
2) the Community Economic Investment Funds Tax Credit (1999) expanded the Equity Tax Credit by offering a partial guarantee on the last 20% of an investment in areas outside of Halifax, Dartmouth, Bedford and Sackville for the first four years. Shares in Community Investment Funds are also pre-approved as holdings in self-directed RRSP accounts.

To read the positive reviews see: Government of Nova Scotia, *Equity Tax Credit Act and Community Economic Development Investment Funds Review*, 2002. The creation of CEDIF tax credits required a modification to the Nova Scotia Securities Act; see Davis, 2003 p. 17-18.

[15] Initiated in 1991, Manitoba's Rural Development Bonds Program (Grow Bonds) was established to assist rural entrepreneurs in attracting investment while protecting investors with a provincial guarantee for every dollar invested. Since 1991, there have been 24 Grow Bond issues worth a total of $12,360,000. Twenty-two projects were funded and 707 people have been employed by companies that receive this financing (Davis, 2003, p.18).

[16] The Manitoba CED Tax Credit (2002) is a non-refundable, 30% personal income tax credit for resident investors in eligible community enterprise development projects (Davis, 2003, p.18).

Associations[17] and Community Business Development Corporations; a national forum of cooperative funders and financers, a national CED forum for credit unions (SIO and Riverdale, 2003, p.7-8), and the very recent creation (June 2004) of a Canadian CI Network.

The literature confirms that there are a variety of CI instruments servicing niche markets that are not being adequately served by conventional financial institutions; that CIs finance seemingly "high risk" transactions in a prudent and effective way; and that they generate a variety of impacts in the communities they serve. The impacts, however, go well beyond the new jobs and new affordable housing units created, but accounting for other impacts remains somewhat elusive.

ii. Sustainable Venture Capital Investing

Sustainable Venture Capital (SVC) is often considered a subset of CI, though others see it as falling broadly within SRI screened portfolios. For the most part place-based SVC initiatives are included within CI and national or international SVC investments are included within SRI screening. The literature does not treat SVC in this fashion, in any case, with most addressing either the environmental or clean technology aspects or, alternatively, the community development angle. Indeed, researchers (O'Rourke and Randjelovic, 2003; Dick, 2004) have found a lack of fundamental research and virtually no basic information as to who is doing what in the sustainable venture capital area.

In terms of the overall SVC industry, the SVC market is still maturing; fund sizes and deal sizes are still relatively small, most funds are not as active in start-up stage investment as they are in expansion-stage, and there is no clear story to tell about their financial success. (Clark et al., 2003, p.10) Only half of all SVC funds evaluate the social or environmental impact[18] of their investments and the funds tend to be more confident about their commitment to achieving impact than about the impact itself. (Clark et al., 2003, p.9)

A few conditions are deemed essential to the growth of SVC: (1) successful exits from deals and more consistent and reliable financial returns data (Cleantech, 2003; Clark et al., 2003; Wustenhagen, 2004); (2) awareness raising, education and training of both VC investors and sustainable project promoters seeking VC financing ((Randjelovic and O'Rourke, 2002); and (3) co-investors, or the participation of major institutional

[17] Community Futures organizations have provincial associations that come together under a pan-Canadian association. They are funded by Industry Canada's Regional Development Agencies, and so are grouped as: Atlantic Canada Opportunities Agency (ACOA); Canada Economic Development for Québec Regions (DÉC); The Federal Government's Initiative for Northern Ontario (FedNor) and Western Economic Diversification (WD).

[18] A variety of external resources and tools are used for this evaluation: metrics developed in collaboration with McKinsey & Company; AtKisson Index of Sustainability; CERES standards on global environmental impact reporting; the CDCV criteria; the Roberts Enterprise Development fund's Social Return on Investment (SROI), and the Rockefeller Foundation has been working on tools to assess and/or monetize their social impact.

investors to complement the strategic investors who have anchored the leading SVC funds to date (Cleantech, 2003; Clark et al., 2003). On this third issue, Sustainable Development Technology Canada (SDTC), a not-for-profit foundation established by the Government of Canada in 2001, was created to "de-risk" clean technologies and help render them more attractive to the investment community. In addition, environmental mitigation regulation imposing internalization of externalities by polluting sources could further facilitate investment in this sector. Traditionally, environmental 'externalities' are not adequately priced or valued in the market, and these market imperfections can hinder eco-innovations. "As long as markets do not punish environmentally harmful impacts, competition between environmental and non-environmental innovation is distorted" (Rennings, 2000, p.326). Regulatory guidelines, such as the IPPC Directive[19] in the EU, are one way of curbing such imperfections. (Randjelovic and O'Rourke, 2002, p.14)

While united by a desire to achieve social and environmental impact through private equity investing, four community development fund "types" have emerged in the US: VC with a Conscience[20], which represents about 22% of all SVC community development funds; the Industry Change-Focused VC Fund[21], which represents about 29% of all SVC community development funds; the Leadership- or Development-Focused VC Fund[22], at around 32%, and the Nonprofit Social Investment Fund[23] at around 17% (Clark et al., 2003, p.6-7).

iii. Economically Targeted Investing

SVC or community investing by pension funds and other institutional investors is often referred to as Economically Targeted Investments. ETIs are not by definition an asset class in and of themselves. Rather, they form an investment perspective that, with all else being equal, recognizes collateral benefits (Hebb, 2001 p. 10). Indeed, in recognizing

[19] The Integrated Pollution Prevention and Control (IPPC) directive was issued in 1996 for EU countries. Integrated pollution prevention and control concerns highly polluting industrial and agricultural activities (energy industries, production and processing of metals, mineral industry, chemical industry, waste management, livestock farming, etc.). The Directive defines the basic obligations which cover a list of measures for tackling discharges into water, air and soil and for tackling waste, wastage of water and energy, and environmental accidents. They serve as the basis for drawing up operating licenses or permits for new or existing installations, thereby driving eco-innovation. A transitional period (30 October 1999 - 30 October 2007) is laid down during which existing installations can be brought into conformity with the requirements of the Directive. See Council Directive 96/61/EC of 24 September 1996 concerning integrated pollution prevention and control [Official Journal L 257 of 10.10.1996].

[20] Mainstream VC that has made a commitment to devote some portion of capital to deals or entrepreneurs with explicit social or environmental goals.

[21] The primary product or service of the businesses in which they invest are inherently pro-social or pro-environmental.

[22] Invests in projects owned, managed or employing marginalized populations, regardless of the product or service they provide.

[23] Exists within a private foundation or public charity and makes equity investments in private companies as a means to support the mission of the charity.

that capital markets are not neutral on issues of local development, jobs and other social goods, long-term institutional investors can decide to be more strategic about the obtainment of collateral benefits all while treating earnings as the first priority (Falconer, 1999, p.5).

Compared to their American counterparts, pension funds and other institutional investors in Canada have very limited exposure to private capital markets, and there is no broad legal framework in Canada that clarifies and establishes parameters for the targeted investment concept (CLBC, 2001; Yaron and Kodar, 2003). In the US, the ETI model was given a decisive boost in the mid-1990s when ERISA regulators made a series of official pronouncements confirming its fiduciary permissibility if appropriate risk-adjusted returns are ensured[24] (Falconer, 1999, p.80).

Despite the lack of permissive government legislation in Canada clarifying the legality of ETIs, several important Canadian models exist, especially in Quebec and British Colombia.

The ETI literature generally seeks to raise awareness and knowledge of the profound effects pension funds have come to yield, highlighting both the danger (Baker and Fung, 2001) and the opportunity (Calabrese, 2001; Hebb, 2001) that the growth of these enormous capital pools presents to working people; examining the obstacles facing ETI (Zanglein, 2001; Falconer, 1999; CLBC, 2001; Carmichael and Quarter, 2003) and suggesting that pension fund trustees and money managers consider the macroeconomic implications of their investments on long-term portfolio performance.

All policies and processes for investing the assets of pension funds originate with the promise to plan members of retirement income and the strategies chosen to reliably meet that promise. (Falconer, 1999, p.17) Promoters of ETI point to inefficiencies and gaps in the financing continuum of national economies, arising in part from costly and asymmetric information, and making the combination of market-rate returns *and* collateral benefits possible. (Calabrese, 2001; Hebb, 2001). Advocates of ETI argue that a rising tide raises all ships. For the California Public Employees' Retirement System (CalPERS), for example, "[i]t is clear… that the present and future financial health of our

[24] The Interpretive Bulletin 29 CFR 2509,94-1

> …sets forth the Department of Labor's interpretation of sections 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA), as applied to employee benefit plan investments in "economically targeted investments" (ETIs), that is, investments selected for the economic benefits they create apart from their investment return to the employee benefit plan….[T]he Department has issued a regulation…[which] provides that the prudence requirements…are satisfied if (1) the fiduciary making an investment or engaging in an investment course of action has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant, and (2) the fiduciary acts accordingly… (The Interpretive Bulletin 29 CFR 2509, 94-1).

trust fund is inextricably linked to the economic health of California" (Harrigan, 2003 p.241).

While no systematic financial evaluation of the various ETI programs exists, in 1995 the U.S. General Accounting Office (GAO) surveyed a majority of public pension funds in the U.S. and found that most ETI programs were outperforming their benchmarks[25]. (Hoffer, 2004, p.7)

While comprehensive evaluation and documentation of the impacts of ETIs are limited, a variety of figures related to job creation do exist. The US high-paid workforces of venture-backed technology firms are credited with creating knowledge workers at four times the level of similar employment created by that country's top 500 publicly-listed corporations (Falconer, 1999, p.27). In Canada, between 1991 and 1996 close to 17,000 jobs were created by 420 venture-backed companies at an exponential growth rate of 26 percent per year (Falconer, 1999, p.27). The ETI literature generally believes that pension funds and other institutional investors will be able to replicate this labour market growth rate were they to have more significant private placement holdings.

While private and public sector pension funds in the US were typically responsible for approximately 50% of all new venture capital on an annual basis during the 1990s, only a handful of extremely large public sector pension funds in Canada are engaging in private placement investment. The ability of the Caisse de Dépôt et Placement du Québec (CDP), Ontario Municipal Employees Retirement System (OMERS), British Columbia Investment Management Corporation (BCIMC), and Hospitals of Ontario Pension Plan (HOOPP) to enter these markets is attributed to their size (Falconer, 2002).

Labour-Sponsored Investments Funds (LSIFs) – a uniquely Canadian approach to economically targeted investing – control more than 50 percent of the available venture capital market (Carmichael and Quarter, 2003, p.18). LSIFs represent capital that is designed to meet gaps in markets for small- and medium-sized firms in particular provinces, as defined by the fund, and possibly in particular sectors of the market, if the fund is specialized. They are required by law to diversify their investments and to minimize risks. To encourage participation in labour-sponsored investment funds, participants receive tax credits (federal and provincial) of 30 percent of their investment (Carmichael and Quarter, 2003, p.16-17).

It becomes evident that in the US as in Canada (with the LSIFs), where there is a legal structure and government support, ETIs represent an effective strategy for job and wealth generation.

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[25] The benchmarks used to analyze the financial returns of ETI programs for the purposes of the survey were designated as such by the GAO and were generally similarly-rated, conventional instruments. The ETI programs that were underperforming these benchmarks were short term funds (3- and 6-month certificates of deposit), younger VC funds, and about half of older VC funds.

iv. Social Impact Metrics

Many believe that an important future driver of the growth of CI, including SVC and ETI, is the ability to quantify its social and environmental impact. In business, there are generally accepted principles of accounting and an international legal infrastructure to help manage the reporting of financial returns. A comparable standard for social impact accounting does not yet exist. The Double Bottom Line Project (2004) released a catalog of methods that for-profit and nonprofit social ventures and enterprises can use to assess the social impact of their activities. The Catalog analyzes feasibility and credibility of nine methods and provides examples of them in use.

An issue that frequently emerges relates to attribution, the degree to which the result of an activity would have happened anyway and the percent that could be attributed to the activity in question. As a result, current working metrics tend to look at outputs rather than true impacts. (Clark et al., 2004)

The Social Return on Investment (SRIO) is one method of assessing social value. In the broadest sense, SROI is an attempt to quantify the social value being generated by an organization as a result of an investment made in that organization. SROI is proposed as an evaluation strategy to determine what organizations and programs are delivering the 'best' social returns. It is defined as a "return" because it is a result of resources (financial and human) invested. SROI's distinguishing feature compared to the more traditional "return on investment" (ROI) is that the units being measured encompass social and/or environmental impact. SROI also includes the measurement of social value creation in terms of outcomes in the broader ripple effects through proxy identification, etc. (REDF, 2004). Some use it as a monetization of the social benefits and costs relative to the financial costs of an enterprise's operations. In this interpretation, the SROI is based on the net present value of these non-market outputs in dollar terms. SROI methodology is deemed more credible than most other impact measurement approaches presently employed in the social venture field because it is based on actual data of a venture's outputs and outcomes, and on proxy research (Clark et al., 2004).

Simple cost-benefit analysis typically frames benefits and costs as trade-offs, and does not facilitate planning or prioritizing which results in the optimization of both financial and social value creation. Emerson (2003) argues that financial and social values are wrongly viewed as two separate aspects of an investment and posits a "Blended ROI" which provides an optimal measurement that integrates both social and financial returns.

Social impact methodology, similar to the CI sector, is very much a "work in progress", though attempts to further quantify the social and environmental venture field promise to go a long way to bridging the information gap in the social capital marketplace.

Conclusions:

1. In the US, government legislation and programming have been key drivers of the community investment industry. Canada lacks a broad framework of national

legislation and government programming to encourage CI and it is assumed that this explains much of the relative lag in community investment in Canada as compared to the US.

2. The Sustainable Venture Capital (SVC) market is still maturing, and is mostly in expansion stage financing as start-up stage financing is even higher risk. A few conditions are deemed essential to the growth of SVC:
   - successful exits from deals and more consistent and reliable financial returns data;
   - training, education and awareness raising on both 'sides' of SVC investment
   - co-investors (Sustainable Development Technology Canada is a first initiative on this issue); and
   - environmental mitigation regulation imposing internalization of externalities by polluting sources could further facilitate investment in this sector.

3. It seems evident that in the US as in Canada, where there is a legal structure and government support, ETIs represent an effective strategy for job and wealth generation.

APPENDIX B – SENSITIVITY ANALYSIS

The following are two related but different analyses proposed by the US SRI industry which attempts to demonstrate that, on the one hand (Table A), below market CI investments (this paper would use the term 'near market') by and large have a negligible impact on overall portfolio returns, and, on the other hand (Table B), community investing can leverage higher social returns than simple charitable donations.

A) SENSITIVITY ANALYSIS ON ANNUAL RETURN

	Principal	**Annual Return***	**Appreciation**
1) 95% 60/40 Equity/Bond Investment*	$95,000	8.52%	$8,094
5% Traditional cash component**	$5,000	4.18%	$209
100% Balanced Portfolio	**$100,000**	**8.30%**	**$8,303**
2) 95% 60/40 Equity/Bond Investment*	$95,000	8.52%	$8,094
4% Community Invest. cash component**	$4,000	4.18%	$167
1% Below Market Com Investment***	$1,000	2.00%	$20
100% Portfolio w/Community Investment	**$100,000**	**8.28%**	**$8,281**

**Based on the average return for the ten years ending12/31/02 of 60% S&P 500 equity and 40% Lehman's bond indices.*
***Based on the average return for the ten years ending12/31/02 of the Lipper Money Market Fund Index.*
****This example uses below market community investment with an average 2% dollar weighted return.*

Source: Calvert Social Investment Foundation

B) THE IMPACT OF COMMUNITY INVESTING VERSUS CHARITY

When an individual makes a $20 donation:	**When an individual invests $1,000 in a community investment at 3%:**
The individual gives $20	The individual's interest earnings may be reduced by $20, compared to a 5% T-bill investment
And only $20 goes to work helping people	While the entire $1,000 goes to work helping people help themselves

Source: Calvert Social Investment Foundation

APPENDIX C – FUND MANAGER INTERVIEWEES

Fund Manager Interviewees

	Total Assets	CI Assets
VanCity Community Foundation	$ 10 million CDN	$ 1 million
Domini Social Investments	1.7 billion US	55 million
Loring Woolcott Coolridge	1 billion US	25 million
Meritas Mutual Funds Inc.	54 million CDN	.5 million
Public Service Alliance of Canada Pension Fund	178 million CDN	5 million

GLOSSARY OF TERMS

Blended Return On Investment (Blended ROI) – Originating from return on investment (ROI), this term describes the integrated and aggregated social and financial returns of a business operation.

Community Investment (CI) – Investment for the purposes of financing deep-seated needs of local communities not addressed by mainstream finance, including poverty alleviation, community and co-operative development and environmental regeneration.

Capital Gap – Refers to the lack of traditional and charitable financing available to support the growth of social and environmental enterprises because traditional financing focuses entirely on financial returns while charitable financing seeks social returns. As the sector between these two traditional approaches (the social economy) generates both social and financial returns, financing is relatively scarce.

Double Bottom Line (DBL) Investing – Investing which strives to achieve measurable financial and social or environmental outcomes.

Economically Targeted Investment (ETI) – ETI is defined as institutional asset allocations that obtain both market-grade returns commensurate with risk and collateral (social) benefits by addressing perceived financing gaps and under-investment.

Micro-credit – Refers to loans under $25,000 made to entrepreneurs who typically cannot access traditional forms of commercial financing for their businesses. These loans are generally paired with business training and technical assistance.

Social Capital Markets – Capital markets specifically for community and social investment which generate both financial and social returns, typically considered to include the range of capital instruments from outright grants to below market or concessionary capital to risk adjusted rates of return. Often further considered to include certain human capital (e.g. volunteering, pro bono services, network capital, etc.).

Social Economy – Enterprises that fulfill the following objectives: (1) financial viability; (2) capacity to create stable employment; (3) responding to social needs; (4) produce goods and services which correspond to unmet needs; and (5) contribute to improving the quality of life of workers in local communities. (Quebec Government definition. See Footnote 12 for the Federal Government definition.)

Social Return On Investment (SROI) – In the broadest sense, Social Return on Investment (SROI) is an attempt to quantify the social value being generated by an organization as a result of an investment made in that organization. SROI is proposed as an evaluation strategy to determine what organizations and programs are delivering the 'best' social returns. It is defined as a "return" because it is a result of resources (financial and human) invested. SROI's distinguishing feature compared to the more traditional "return on investment" (ROI) is that the units being measured encompass social and/or environmental impact. Also includes the measurement of social value creation in terms of outcomes in the broader ripple effects through proxy identification, etc. See www.redf.org for industry leadership in this area.

Sustainable Venture Capital (SVC) – Refers to the sub-sector within the venture capital industry that proactively invests in social and environmental technologies, processes and enterprises within professionally managed venture capital portfolios.

Triple Bottom Line (TBL) – Investing which strives to achieve measurable social, environmental and financial outcomes.

Underserved Populations/Disinvested Communities – A business opportunity overlooked by traditional financial institutions and other profit-oriented businesses, typically including economically depressed areas such as rural and inner-city locales, racial and ethnic minorities, recent immigrants and low and moderate income households.