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REPORT ON IMPACT INVESTING IN CANADA

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A. INTRODUCTION

In March 2014, the MaRS Centre for Impact Investing and Purpose Capital jointly released a report entitled "State of the Nation: Impact Investing in Canada"[1] (the "Report"). The Report is the first of its kind to provide an update on the state of the impact investing sector in Canada. The purpose of the Report is to respond "to a need to better understand the nature of impact investing activity in Canada, the ways in which it is evolving and maturing, and the areas in which it could grow or falter." Impact investing involves a broad range of approaches and organizations, encompassing foundations that supply capital on the one hand and "non-profits" (which would include registered charities and non-profit organizations under the *Income Tax Act*) and social enterprises (which the Report defines as "organizations that employ market-based strategies to accomplish a social or environmental mission") that demand and receive capital on the other hand. This *Charity Law Bulletin* provides an overview of the findings of the Report, explains what impact investing is, and briefly comments on how impact investing may affect non-profits.

B. WHAT IS IMPACT INVESTING?

The Report defines impact investment as "investments intended to create positive impact beyond financial returns." While in a traditional bifurcated system, governments and community organizations use grants, donations and non-repayable contributions to finance social needs, and capital markets aim to create

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[1] The Report is available from MaRS Discovery District, online at: <http://impactinvesting.marsdd.com/wp-content/uploads/2014/03/Impact-Investing-in-Canada-State-of-the-Nation.pdf>.

financial returns and capital growth, impact investing attempts to amalgamate these functions, such that investors and investees intentionally create a measurable positive impact that stretches beyond financial returns. It is a method of financing new mechanisms that bridge the public, private and social sectors in order to accelerate positive social change. In brief, impact investing involves "intentionally investing for financial returns and positive social impact."

Impact investing differs from traditional investment in three key ways. Firstly, whereas in traditional investment, investors allocate capital where they can get a financial return, in impact investing, investors allocate capital where they can receive a financial return *and* a defined societal impact. Secondly, investees follow business models that intentionally return both financial and social value. Thirdly, the stated intentions for financial and social value must be translatable into a measurable social impact.

Impact investing involves three key market segments – those that supply capital and provide the investment, those that demand capital and seek the investment, as well as intermediaries and enablers that facilitate both the supply and demand and ensure that the demand is properly being met with the correct supply. The supply generally comes from individuals, foundations, community finance organizations, financial institutions, pension funds and government, while demand generally comes from companies, non-profits, and co-operatives.

The Report provides various examples of impact investing. The RBC Generator Fund is one example, which was established as a $10 million pool of capital for the purpose of investing in for-profit businesses whose purposes are to tackle social and environmental problems, such as energy, water, youth employment, and community hiring for disadvantaged groups. While tackling these issues, the for-profit businesses continue to aim to general market or near-market value. Another example is Renewal3, which was established as a trust structure so that foundations could invest in mission-related investments.

C. THE SUPPLY – FOUNDATIONS

The Report states that foundations are among Canada's "leading impact investors across several sectors," and are most active in community development, health, children and youth, education and social services. A survey of 63 Canadian foundations conducted by MaRS found that Canadian foundations mostly provided debt financing to NPOs and social-purpose for-profit organizations, with 77% of surveyed foundations investing through a third-party impact fund or capital program.

Foundations across Canada have invested approximately $205.5 million in mission-related investments (“MRIs”) (which the Report states “seek opportunities to align a foundation’s financial investments with the mission of the organization, while maintaining targeted financial returns”) and $80.3 million in program-related investments (“PRIs”) (which the Report defines as “investments, rather than grants, made to a qualified donee…[that] are for the primary purpose, not of income generation, but of furthering the foundation’s charitable purposes.”). However, impact investing is spread amongst a relatively small number of foundations, with many foundations only now beginning to explore the concept of impact investing. While 31% of the surveyed foundations had a strong understanding of impact investing, only 16% had stated policies on impact investing. However, the surveyed foundations indicated an intention to increase their MRIs by 29.5% and their PRIs by 23% over the next five years.

While many foundations indicated that their investments had met their financial expectations, they also indicated a need for greater clarity from the Canada Revenue Agency about the allocation of capital, such as MRIs and PRIs, and their ability to directly invest in impact funds. Foundations faced challenges directly investing in impact funds, as many impact funds are structured as limited partnerships, which private foundations are prohibited from investing in. As such, the Report stated that “foundations could be ideal impact-first investors in investees with high social value or could unlock capital from other investors if their challenges can be addressed.”

D. THE DEMAND – THE NON-PROFIT SECTOR

Despite charities generating $177 billion in revenue between 2005 and 2009, the Report stated that the non-profit sector has significant unmet capital needs. The Report states that 66% of social enterprises run by charities were seeking capital between 2010 and 2012, with half of those looking for $50,000 to $1 million. While the non-profit sector obtains most of its funding from the government, foundations and donors, the Report states that these sources provide an insufficient diversity and quantity of capital. As such, impact investors “play an important role in unlocking capital for non-profits and social enterprises that are harnessing business models that align with their missions and that have the ability to generate both financial returns and amplify social impact.”

Non-profits face particular problems with accessing capital, as they cannot guarantee loans, leverage assets, or provide exit strategies for investors. Consequently, the Report states that most non-profits are financed through loans. However, a small number of suppliers, including Vancity, the Canadian Alternative Investment Cooperative ("CAIC"), the Community Forward Fund, and the Edmonton Social Enterprise Fund are engaging in impact investment in social-purpose organizations such as non-profits. For example, after investments from the government of Nova Scotia and the YWCA to build a YWCA daycare and office space, CAIC took the risky position of providing the YWCA with a second mortgage and acting as a second lender, but did not do so at the higher interest rate commonly charged by second lenders. CAIC has nonetheless reported that their investment has met their financial expectations and that the daycare has had full enrolment, providing a strong social return as well.

As the lack of diversity and quantity of financing options is a major hurdle for the non-profit sector, the Report calls for new corporate forms that enhance the ability of social purpose organizations to access debt and equity financing, government enabled loan guarantees, and patient capital pools.

E. CONCLUSION

While impact investment remains a relatively new and emerging concept, the Report demonstrates that this new mechanism can benefit a wide array of organizations within the non-profit sector, including charities. Impact investing provides a method of financing that has the potential to bring capital to the suppliers and provide capital to those who demand it, all the while aiming to generate measurable social change. This is a welcome development and one which hopefully the federal, provincial and territorial governments will be encouraging and facilitating in the future in tangible and innovative ways.