

# Overcoming Your Foundation's Barriers to Impact Investing

4/4/2021



**Arabella**  
Advisors

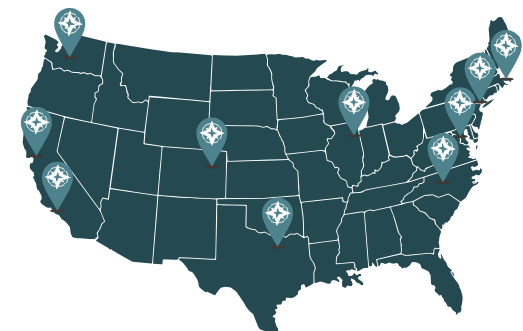
# Arabella at a Glance



- Services more than **400 client engagements** annually
- Is the **largest philanthropic consulting firm** with the **widest range of services**
- Influences more than **\$4B in philanthropic assets** annually

- Employs **250+ staff members in 10 major centers of US philanthropy**

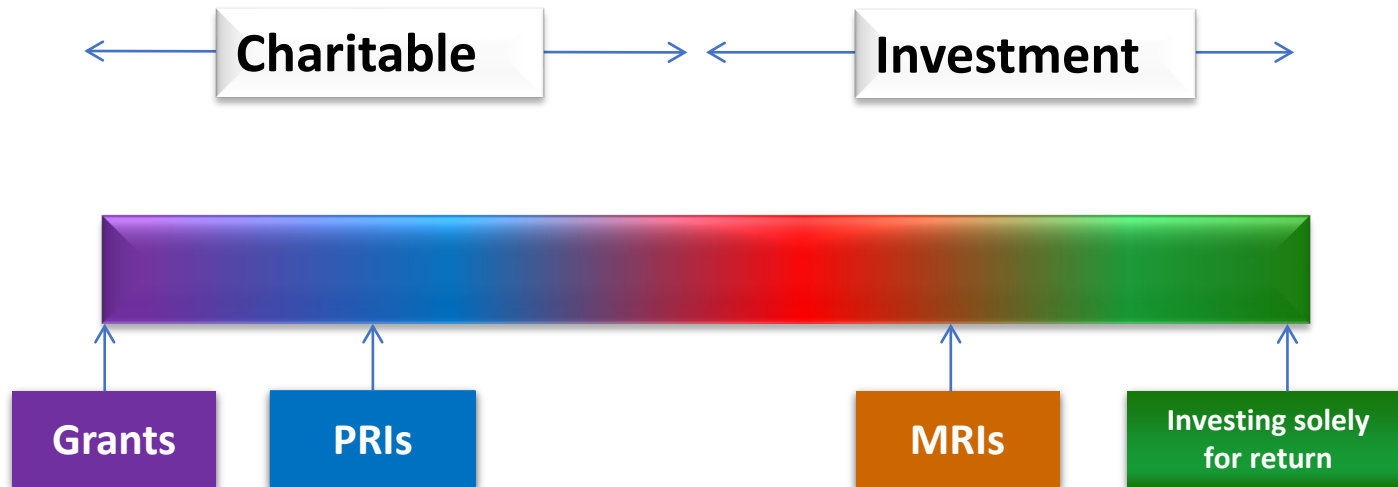
*(Boston, Chicago, Dallas, Denver, Durham, Los Angeles, New York, San Francisco, Seattle, and Washington, DC)*



AWARDS



# Spectrum of Investing



# Mission-Related Investing (MRIs)

- **IRS Notice 2015-62**
- Can take into account whether the investment **further**s a PF's **charitable mission**
- PF not subject to jeopardizing investment excise tax if investment that **further**s charitable purpose has a **lower return**

# Program-Related Investments (PRI)

- **PRI's** are a form of charitable investing
- Typically, a loan, credit guarantee or equity investment
- Count as qualifying distributions for 5% payout and are not part of investment portfolio
- IRS issued final regulations containing 9 new examples (4/21/16)

# Three Requirements of PRIs

- **Primary purpose** is to accomplish one or more of foundation's exempt purposes
- Production of income or the appreciation of property is **not a significant purpose**
- **No purpose** of the investment is to influence legislation or intervene in political campaigns of candidates for public office

- IRC Section 4944(c); Treas. Reg. §53.4944-3(a)

# Primary Purpose of PRI

- The Primary Purpose of a PRI must:
  - Significantly further the foundation's exempt purposes; and
  - Would not have been made but for the relationship between the investment and the accomplishment of the foundation's exempt activities.

# Profit Not Significant Purpose

- Would for-profit investors likely make the same investment?
- Production of significant income, by itself, is not conclusive
- Typical example – loan at below-market interest rates



# Lobbying and Political Activity Prohibited

- PRI's purposes cannot include:
  - Attempts to influence legislation
  - Aid or oppose candidates engaged in political campaigns

# Expenditure Responsibility (§4945)

- Funding to a non-charitable entity requires exercise of expenditure responsibility:
  - Due Diligence (pre-grant inquiry)
  - Written Agreement
  - Annual and Final Reports
  - Record Keeping by investee
  - IRS Reporting (990-PF)
  - Maintenance of Records

# Benefits of PRIs to a Private Foundation

- Counts as Qualifying Distribution (§4942)
- Calculated as Charitable Use Asset
- Exception to Excess Business Holdings (§4943)
- Exception to Jeopardizing Investments (§4944)
- Note: Self-dealing rules still apply (§4941)

# Effects of PRIs

- PRIs are reported on the 990-PF
- When repaid, required annual charitable disbursement is increased by repayment
- Interest/income on a PRI is reported as investment income, subject to the excise tax for net investment income
- If not repaid, treated as a grant
- PRI's administrative expenses are direct charitable expenditures

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# Muse Family Foundation

- Est. 1999 by John and Lyn Muse
- History of supporting education initiatives, the arts and community development
- Strategy has evolved to focus on access to opportunity and economic mobility in Dallas

# Existing Community Partners



**Booker T. Washington**

High School for the Performing and Visual Arts



**Dallas County  
Community College District**









2021

# City of Dallas Housing Statistics

- 6 out of 10 families in Dallas are Housing Cost Burdened
- Dallas has a housing shortage of 20,000 affordable units
- For every 100 low income renters, there are only 19 low income housing units available locally (DFW-Arlington)

# 2020-2021 Impact Investments

## Mission Related

- Equity investment in MTO Fund
- Equity investment in NOAH housing

## Program Related

- Loan to CDC to build affordable, single-family housing + capacity building grant

# Overview of Michael & Susan Dell Foundation

# Overview of Michael & Susan Dell Foundation

## MISSION

Our mission is to transform the lives of children living in urban poverty through education, health, and financial economic stability.

## VISION

We solve real-world problems to accelerate human opportunity. At scale.

## FOUNDED IN 1999

by Michael and Susan Dell

## GLOBAL ANNUAL COMMITMENTS

~USD \$125M  
450+ Active Projects

## GLOBAL COMMITMENTS

~USD \$1.7B  
3,068 total projects

## 3 GLOBAL OFFICES

112 team members



UNITED STATES



INDIA



SOUTH AFRICA

# Impact Investing Activities (To Date)



Portfolio size	\$105.5M	\$35.5M	\$69M
# of investments	61*	17	43
Investment type	<ul style="list-style-type: none"> <li>• Fund equity (4)</li> <li>• Direct equity (42)</li> <li>• Loan (14)</li> </ul>	<ul style="list-style-type: none"> <li>• Fund equity (1)</li> <li>• Direct equity (5)</li> <li>• Loan (11)</li> </ul>	<ul style="list-style-type: none"> <li>• Fund equity (3)</li> <li>• Direct equity (37)</li> <li>• Loan (3)</li> </ul>
# of exits	11	3	9

\* Includes one investment in South Africa

# Overview of U.S impact investing



# Overview

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Impact investments are Program Related Investments that come out of the grantmaking budget of the Michael & Susan Dell Foundation.

The goal of the portfolio is to invest in **market-based solutions** for underserved, low-income individuals, families & communities in the United States.

**Target segments** are: Jobs & Livelihoods, Financial Services, Education (University Success) and Health & Wellness.

We deploy the financial instrument that best suits the organization. This includes **equity** (likely Seed or Series A), **debt**, **convertible notes** and **guarantees**.



# Snapshot

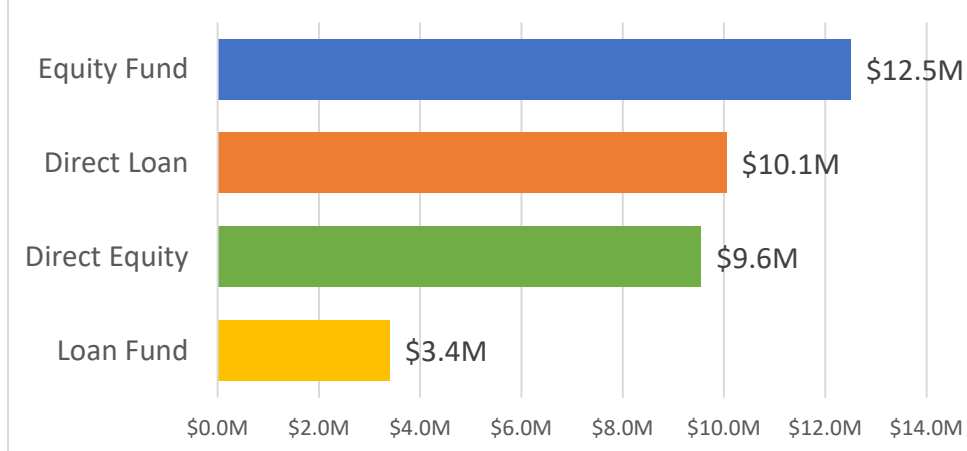
## Current portfolio size

**\$35.5**  
million

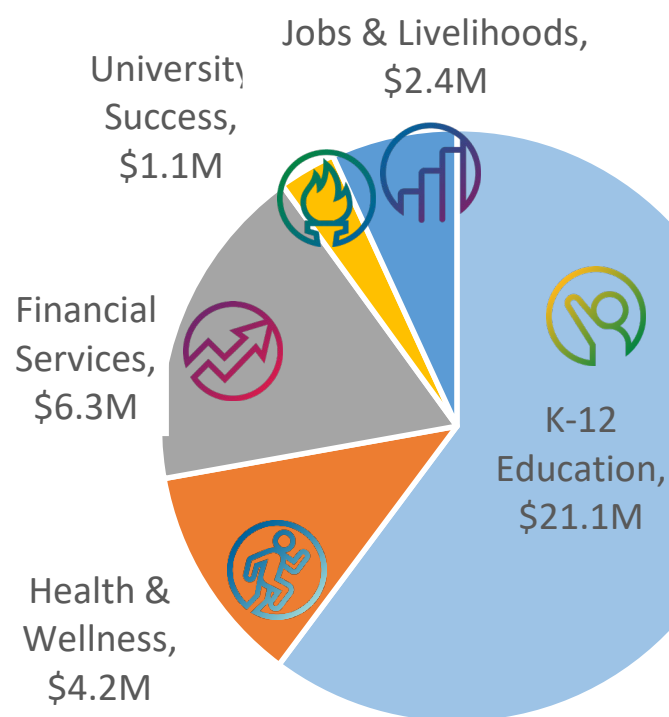
**17**  
investments

**5**  
exits

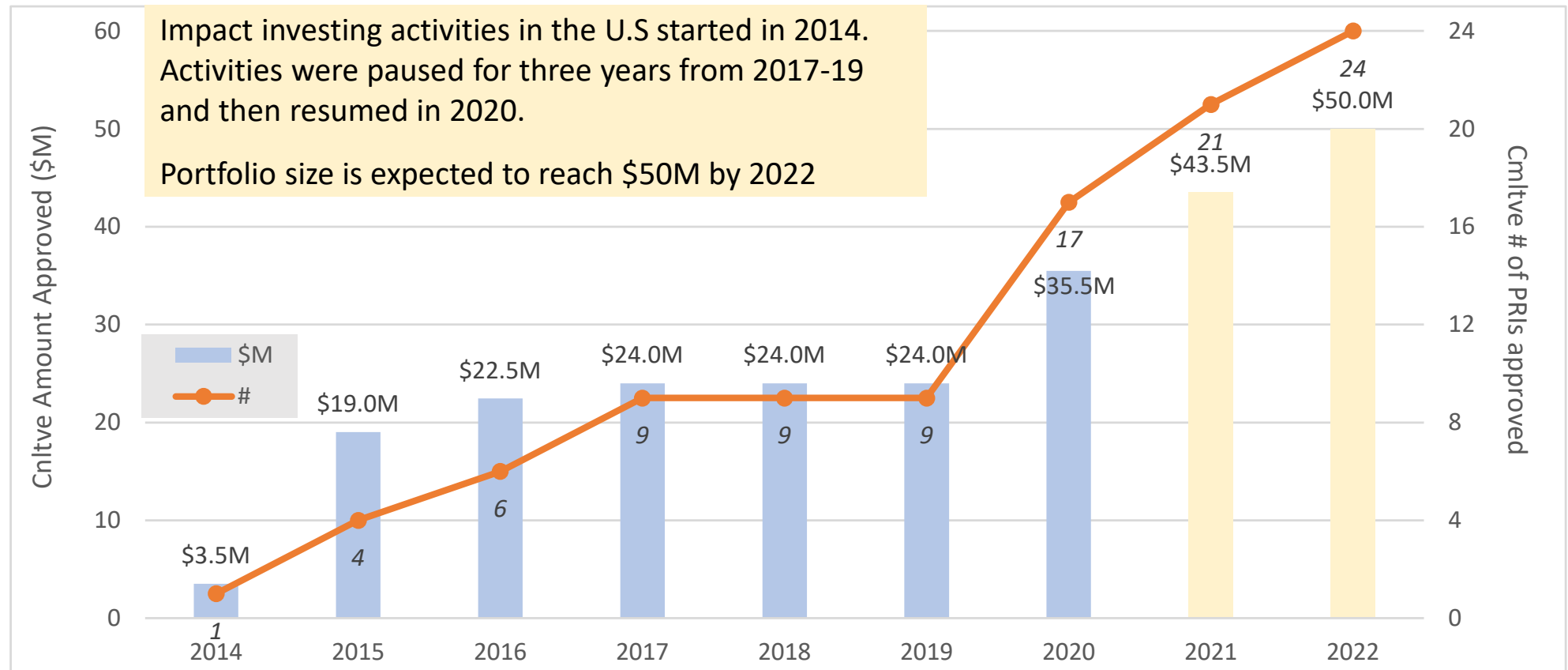
## Four types of funding instruments



## Five impact segments



# Growth of Impact Investing at MSDF US



# Portfolio Impact



## K-12 education (\$21.1M committed, 4 active projects)



\$12.5M (2015)

- \$135M assets under management with investments in 38 portfolio companies
- 10 portfolio companies have more than 1M users (e.g. Newsela 3M and 51% FRL, Class Dojo 35M and 51% FRL, FreshGrade 6M and 56% FRL)



MasteryConnect

\$3.5M (2013)

- Company delivers formative assessment to classrooms. Has 2.4M registered users, of which 650k were active, across 3,500 schools across the U.S
- MSDF **exited** the investment in 2019 at a 27% IRR



\$2.5M (2015)

- Company delivers virtual coaching to teachers. Product has over 600,000 active students on the platform across 2,000 schools.







\$0.95M (2016)

- Company facilitates virtual connections between classroom and industry. Company has over 300,000 active students on the platform across 500 schools
- MSDF holds ~5% stake; largest investor is K-12, Inc.

# Portfolio Impact







## Financial services (\$6.3M committed, 4 active projects)

 \$3.5M (2020)	<ul style="list-style-type: none"><li>Since the onset of Covid, Lift has loaned out over \$50M in six months - twice its pre-Covid run-rate. Small businesses account for 45% of Texas' workforce - stabilizing small businesses during this pandemic is critical to retaining and creating new jobs.</li></ul>
 \$2.5M (2020)	<ul style="list-style-type: none"><li>Grameen America pivoted its entire 50,000 borrower network to virtual operations at the onset of Covid. Six months later, they have seen resounding success: repayment rates are still high (&gt;98%); &gt;\$10M disbursed in the last six months.</li></ul>
 \$550k (2020)	<ul style="list-style-type: none"><li>Kiva has over 3,000 active loans to micro-borrowers across the U.S at an average repayment rate of 85%. Loans are zero-dollar and zero-fee.</li></ul>
 \$150k (2017)	<ul style="list-style-type: none"><li>JUST has 1,300 borrowers in Central Texas and has maintained a 96% repayment rate since inception. JUST is looking to aggressively expand across Texas.</li><li>MSDF was the first institutional investor in JUST.</li></ul>

# Portfolio Impact



## Health & Wellness (\$4.2M committed, 2 active projects)

 \$1.5M (2015)	<ul style="list-style-type: none"><li>• Hope provided low-interest loans to four retailers to increase supply of healthy food in food deserts across south-eastern USA.</li></ul>
 \$1.5M (2017)	<ul style="list-style-type: none"><li>• ACT has preserved affordability for 2,000 units across four properties in Central Texas. At the onset of Covid, it provided additional rental assistance to tenants.</li><li>• MSDF was the first institutional investor in a \$20M affordable housing fund.</li></ul>
 TO THE MARKET \$750k (2020)	<ul style="list-style-type: none"><li>• Since the onset of Covid, TTM has procured and distributed 2.2 million units of PPE within six months (this time last year, they had not procured a single unit of PPE and did not have a single hospital customer)</li><li>• MSDF <b>exited</b> the investment, realizing a 7.3% IRR.</li></ul>
 \$700k (2020)	<ul style="list-style-type: none"><li>• Since the onset of Covid-19, LifeWorks has worked with 50 high-risk youth to provide rapid rehousing and critical wrap-around services</li></ul>

# Portfolio Impact



## Jobs & Livelihoods (\$2.4M committed, 2 active projects)



\$1.9M (2020)

- UP Fund is a target \$50M fund. It seeks to invest in 8-10 training programs that will train 7,000 low-income students and place 6,000 in higher-wage jobs.
- MSDF is one of the first institutional investors into the fund.



## University success (\$1.1M committed, 1 active project)

**edquity**

\$1.1M (2020)

- Disseminating emergency aid is costly and cumbersome for smaller / community colleges especially. Edquity enables a college to outside their emergency aid program, thereby increasing speed of delivery.
- Over the last six months, Edquity has processed 18,000 emergency aid applications, amounting to \$9M.

# 2021 Strategy



Michael & Susan Dell  
FOUNDATION



# Sourcing Themes

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Invest in scalable, sustainable, market-oriented models in two program areas:

- **Financial services:** Improve financial stability for low-income families by creating access to responsible financial services
- **Jobs & Livelihoods:** Provide new career & job opportunities for low-income young adults

Intentionally focus on low-income **BIPOC** individuals, families and communities

Prioritize organizations addressing inequities caused or exacerbated by **Covid-19**

Organization / initiative must be able to return capital within a 3–5-year timeframe



# Financial Services – Preliminary Themes

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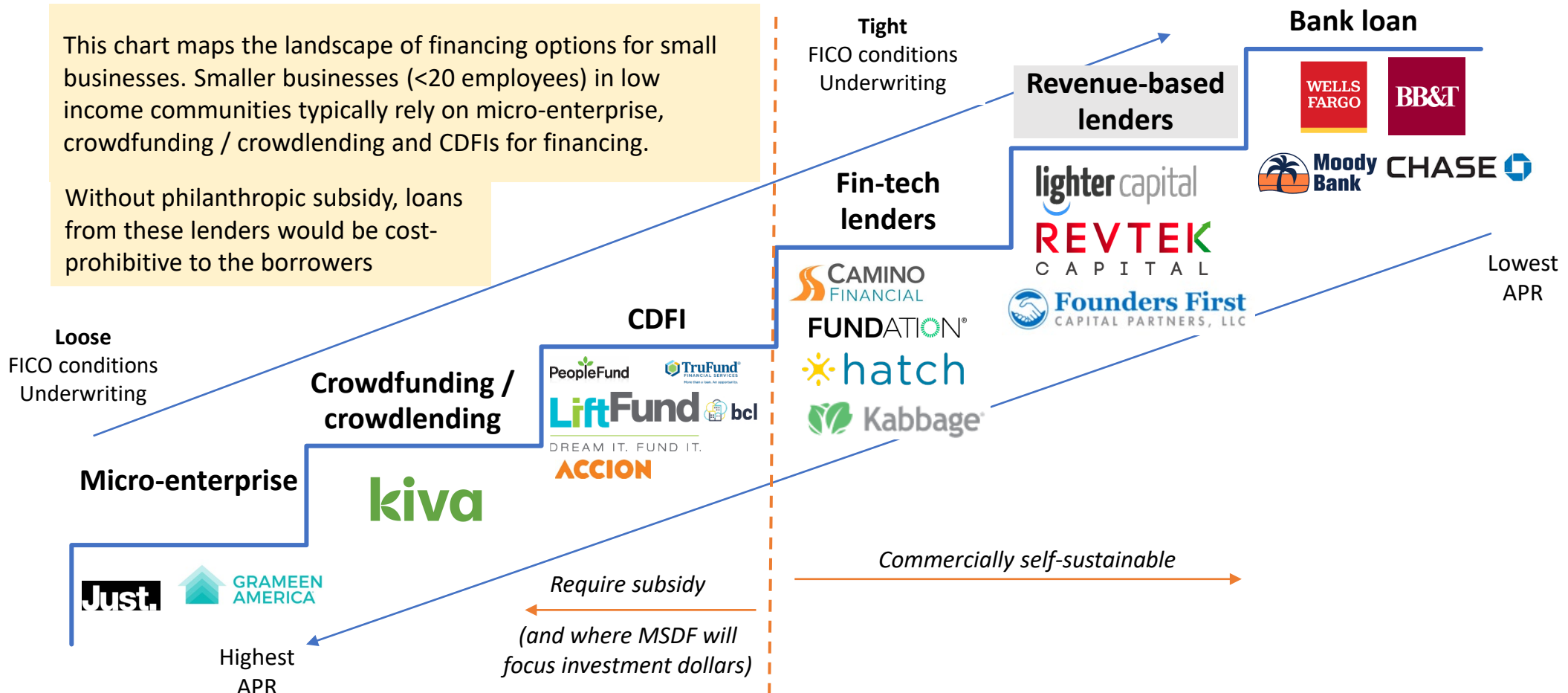
Strategy	Description	Sample orgs
Increase access to credit for low-income BIPOC individuals / families	Companies utilizing different underwriting models to extend affordable credit to low-income individuals / families	Capital Good Fund Esusu Climb Credit
Increase access to services that better manage financial distress	Companies providing low-cost guidance to manage debt loads or reducing cost of existing financing	Change Machine Resolve EarnUp Onward

# Jobs & Livelihoods – Preliminary Themes

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Strategy	Description	Sample orgs
Test & scale borrower-friendly Income Share Agreements (ISAs)	By contributing to an ISA pool of capital, help prove out whether ISAs are a viable form of financing for students	Merit America
Low-interest loan to support / stabilize (non-profit) 'on ramp' orgs	Help 'on ramp' orgs test out other revenue streams, especially with employers, and hence diversify funding mix	Strive Intl Project Quest
Support an early-stage (or series of early-stage) for-profit companies	Experiment with mission-aligned workforce companies across the workforce spectrum	NurseDash Next Step

# Texas Small Business Continuum



# The Arabella Team



**Jeremy Gregg**  
Managing Director

As Arabella's Dallas-based managing director, Jeremy Gregg works to connect ambitious and innovative changemakers in Texas with the full Arabella platform of services to guide them in moving from idea to impact. Gregg has 19 years of experience working with various organizations in Texas to help advance social impact and strengthen the practice of philanthropy. Prior to joining Arabella, Gregg served as the president and founder of Gregg Partners, an impact advisory firm that developed revenue strategies for nonprofits; and Mission Allies Publishing, a mission marketing agency. Gregg serves as a strategic advisor to the Pat & Emmitt Smith Charities, a board member of the My Possibilities Foundation, a guest lecturer for The Warden Exchange, a mentor to several fundraising leaders via AFP Dallas, mentor in the Team 22 program, a hospice volunteer with the Visiting Nurses Association, and a volunteer advisor to the student newspaper at Cistercian Prep School.

Jeremy is also a passionate advocate for poetry (which he has taught everywhere from a prep school to a public school to a prison).

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**Cyrus Kharas**  
Director



Cyrus Kharas is a director on Arabella's Advisory team and the co-head of the Impact Investing team. He works across a broad range of Arabella's individual, institutional, and corporate clients, and contributes to the firm's analysis of trends and opportunities in the impact investing field. Prior to joining Arabella Advisors, Cyrus spent several years at Goldman Sachs in the investment management division, where he focused on cross-asset class allocation and portfolio strategy. Cyrus began his career at the US Treasury Department in the Office of International Affairs. Cyrus has a BA from Tufts University in psychology and economics and an MBA with a concentration in economics from NYU Stern School of Business. Cyrus is an avid soccer player and fan. He lives in Washington, DC with his wife and two daughters.

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## Overcoming Barriers to Impact Investing



From **Idea** to **Impact**

[Overcoming Barriers to Impact Investing Article](#)





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## Supporting CDFIs to Build a More Equitable Post-COVID Economy



**Responding to COVID-19** 

[Supporting CDFIs to Build a More Equitable Post-COVID Economy](#)

# Appendix:

# Investment Philosophy



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# Overview of Impact Investment Philosophy

Through our impact investments, MSDF aims to fill a growing gap between grantmaking and venture-style impact funds

## Grantmaking

### Current funding paradigm

- Project-specific: grant-maker defines a scope, timeline and budget for a project, and allocates a nominal amount (between 10-15%) for indirect expenses.
- Based on calendar year / fixed time unit, as opposed to milestone-based funding.

### Challenges

- Grantee organizations struggle to grow and evolve beyond the pool of projects for which they receive funding
- Can create a cycle of dependence on grants, inhibiting scale and sustainability
- Does not instill a virtuous feedback loop between organization and beneficiary; rather, organization becomes more accountable to grantmaker



# Overview of Impact Investment Philosophy

Through our impact investments, MSDF aims to fill a growing gap between grantmaking and venture-style impact funds

## Venture-style impact funds

### Current funding paradigm

- Many 'impact funds' start off with robust criteria around impact. As the reality of fund economics starts to kick in (i.e., need for a larger fund size to sustain operations), they start to loosen the impact criterion (for both new and existing investees)
- Such impact funds tend to optimize instead for scale, valuation and exit.

### Challenges

- Investees, even if wanting to focus on low-income populations or on impact, are compelled to 'productize' their offering to increase sales volume and profitability.
- Similarly, investees cannot invest in value-add services, typically important to enhancing impact, as it adds to cost and therefore detracts from profitability.

# Overview of Impact Investment Philosophy

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- Funding at the organizational level – not project level – to enable organization to invest in crucial back-end systems and processes
- Technical assistance to ensure organization focuses on serving high quality products / services to low-income consumers
- Flexible, patient capital with focus on sustainability (not just revenue) and organic growth

# Investment Criteria

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An ideal investee will:

- Serve **low-income individuals, families or communities\*** in the United States as their **priority** customer base, not incidental or later-stage
- Be developing a product or service that has potential to drive **scalable, sustainable positive impact** so revenues and impact grow in tandem
- Demonstrate **product-market fit** and **early revenue traction**, with identified movement towards scale and/or recurring revenue
- Have **early evidence of impact** of their product / service on low-income consumers

\* Low-income refers to individuals or families earning less than 80% of area median family income, as defined by HUD. This varies by city. For instance, in Austin, the FY2019 median family income was \$66,000, meaning that <80% median family income was \$52,850.