Investing in Michigan's Future: Community Investment Policies for Michigan's Higher Education Institutions

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Michigan State University, Center For Urban Affairs
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Executive Summary

Around the country for the past 10 years elected officials, scholars, and the general public have made numerous calls for a renewed vision of civic engagement by universities and colleges. The reason – many communities are in decline-resulting from years of neglect, which includes declining revenues and increasing expenses. As these distressed communities are trying to rebuild, often their most significant need is in the form of financial capital. While securing financial capital is often difficult, universities and colleges have the ability to help by using their knowledge and resources, both human and financial.

For years, many American educational institutions have been building endowments of millions or billions of dollars. As security for the future, these endowments are invested in a variety of ways including stocks, bonds, real estate, natural resources, mutual funds, and other options. However, recently some institutions have realized that they can use their endowments to build stronger communities while being fiscally responsible and ensuring institutional stability. This can be done through community investing, which is one aspect of socially responsible investing. Socially responsible investing (SRI) is the process of integrating money and ideals to create positive social change when making investment decisions. Presently, one out of every eight dollars under professional investment management in the United States is subject to some form of SRI criteria.

Currently, community investing is the fastest growing component of socially responsible investing. Community investing is the practice of investing in job creation, affordable housing, small business development, and other community development projects in economically distressed communities. Investors are free to choose investments that have a particular focus or impact a specific geographic area. Community investing takes place when investors direct a portion of their endowments toward community investment options such as community development financial institutions and community development banks. When investments are placed in these various community investment vehicles, they receive a modest yet reliable rate of return, often comparable to traditional investments. At the same time, investors walk away with the knowledge that they are providing low-income communities the financial capital they need to build better neighborhoods, and ultimately a better society.

With renewed calls for civic engagement, the need to attack the root problems of distressed communities, and positive research about community investing, it is now time for universities to explore how they can be involved with community investing and rebuilding communities.

This paper was originally prepared for the Fall 2002 course in Urban Policy Analysis (Urban and Regional Planning 848) at Michigan State University, instructed by Rex L. LaMore, State Director of the MSU Center for Urban Affairs, Community and Economic Development Program.

Introduction

"Our mandate is to inspire young men and women to embrace both the challenges of scholarship and the values of citizenship. This is a mandate that does not fall to Trinity alone, but to all colleges and universities, places that at their best combine excellence in the classroom and laboratory with the highest ideals of service to community and nation. And yet, today, many of our institutions of higher learning are failing to practice what they teach. As they call students to the lessons of citizenship, they continue to hide in the academic watchtower, protected by iron fences and lofty rhetoric. They continue to sit atop endowments that in many cases are in the hundreds of millions, even billions of dollars; arguing that to draw down these resources for civic purposes would undermine their long-term institutional viability,"

- Evan S. Dobelle, Former President, Trinity College

Trinity College is one of several examples of colleges and universities that are investing financially in their community. Trinity has committed $6 million of its endowment toward a comprehensive $200 million neighborhood revitalization effort. Former Trinity College President Evan S. Dobelle's speech emphasized that university leaders need to understand that the connection between a university and the communities they serve is more than typical research and outreach. His belief is that Trinity College as a whole, along with individual students, as a part of the community of Hartford, Connecticut, has a responsibility to help its community with what it needs most – financial resources. With this in mind, he recommends that all colleges and universities reevaluate their commitment to the communities with whom they are linked. One way to do this is for universities and colleges to invest a portion of their endowments in these communities. Not investments as charity offerings, but investments made at market rates, which build stronger communities and provide solid returns to the institution.

Communities throughout the United States will never be fully complete until all of their citizens can build a life for themselves, both the rich and the poor. And currently one of the stumbling blocks for poor communities in general is a lack of capital. This capital is needed to rebuild the infrastructure of various neighborhoods, provide decent affordable housing, and create meaningful employment. A recent survey for the Fannie Mae Foundation found that the most important influence shaping U.S. cities over the next 50 years is the growing gap between the rich and the poor (Rysavy, 2002). This widening gap affects cities of all sizes. Investing in these communities is not only a way to reduce this gap; it is a way to create vibrant and healthy communities that are socially just, with economic equity and opportunity for all.

Universities have not traditionally invested financial resources in poor communities. Their typical investment in these communities has been in the form of human resources through community service, service-learning, outreach programs, and faculty research. While these programs are important and have often produced solutions to various issues, they fail to use the institution's full capacity to attack one of the root problems of distressed communities, *the lack of financial capital*.

Meanwhile, universities and colleges build sizeable endowments for the purpose of supporting their education mission in perpetuity. Endowments can provide stability for years and even decades. They provide funds for faculty, student scholarships, and university-based programs. However, while these large endowments provide stability, universities have the opportunity to look inward at their mission statements and determine what more they can do with this valuable resource.

A traditional defining characteristic of the American university has been its capacity and willingness to help advance the economic, social, and civic vitality of our nation (Sandman, 1996).

Thomas Jefferson believed that the purpose of the university was to foster engaged citizenship. This purpose is being renewed today. Yet, discontent has settled in among the public in their views about the purpose of higher education. This discontent has led to several calls for a renewed civic purpose of universities (Katz & Dobelle, 1999; London, 2002). Research must provide answers to relevant social problems (Witt, 2000). Service must contribute to the university's mission of developing an effective and productive citizenry (MSU, 1982). Resources, both human and financial, must be made available to benefit society as a whole.

The most recent argument by scholars is that university and colleges cannot afford to sit idle in their ivory watchtowers on their endowments and not be actively engaged with communities with which they are linked. Investing financial resources in areas such as community development, local purchasing, small business development and affordable housing is one way to be actively engaged with communities. The mission at Michigan State University (MSU) includes the following statement, "Michigan State University is committed…to contributing to the understanding and the solution of significant societal problems." Could this now be the time for MSU to contribute to the solution of the most significant societal problem, lack of financial capital? If it is, it can do so by investing some of its financial resources, particularly through its endowment, in communities that lack those resources.

Endowments and Investments

Endowments date back to 15th century England, however, they are truly an American phenomenon. They have been existent in universities, hospitals, churches and other institutions in the United States for over 300 years. An endowment is an aggregation of assets invested by a college or university to support its educational mission in perpetuity (ACE, 2000). As an investment in the future, it is a way of providing goods and/or services not just today, but indefinitely into the future. Endowments provide funds both now and in the future through investment earnings. They provide a reliable source of funding for future generations of students. For these precise reasons, colleges and universities often build sizeable endowments to ensure their financial stability and institutional future. However, while much attention is given to the universities with sizeable endowments, having an endowment is somewhat of a luxury. Many universities and colleges have either small endowments or none at all. The median endowment size at private colleges and universities is roughly $10 million and about two-third of these colleges have endowments less than $5 million. On the larger scale of endowments, 368 (roughly 10%) of the nation's colleges and universities have endowments over $50 million. Of those, at least forty are over $1 billion. A study by the Chronicle of Higher Education in 2001 revealed the following about university endowments:

- Harvard University's endowment is currently the largest, estimated at $17.9 billion in 2001.
- The University of Texas system has the largest endowment of any public university at $9.3 billion.
- In only one year between 1984 and 2001 did the average value of university endowments decline.
- The combined total endowments of Michigan's 15 public universities was $4.58 billion as of December 31, 2001.

Hundreds of millions of dollars in endowments are invested each year in various ways. Debt and equity are the two basic categories of investments. Debt investments make loans to companies in the form of corporate bonds or bank notes. Equity investments are when investors buy a part of a company (e.g., common stock shares). Equities are where most innovative investors operate as they provide potentially higher returns. Some potential vehicles for general investing include stocks, bonds, mutual funds, government issues, real estate, natural resources, and bank accounts.

Some universities have begun to realize that amassing endowments of this magnitude – while beneficial for their school, students, and faculty – can also be utilized to benefit the communities in which they work, support, and recruit students from. The possible infusion of investment money into distressed communities not only provides needed capital for various community development projects, *but it can provide returns comparable to traditional investments*. And in many cases, investors are willing to accept a lower return on investment with the knowledge that their investment will have a *higher indirect or secondary rate of return*. By investing in local communities, universities show a true commitment to communities with which they are linked. This can demonstrate to students that service, which is often linked with scholarship on campuses, is more than meals served by students at the local soup kitchen or mentoring programs for community youth. Investing in communities is not difficult. It simply takes institutional leadership to develop a socially responsible investing (SRI) policy that focuses on community investing.

Socially Responsible Investing (SRI)

Socially responsible investing is the process of integrating money and ideals to affect positive social change through investment choices. Socially responsible investors make investment decisions based on individual or institutional values regarding social and environmental issues. Their primary concern is to use their investments as a vehicle to build strong communities, while earning a return on their investment similar to traditional investment options. Social investors consist of a broad spectrum of investors, including individuals, corporations, universities, hospitals, foundations, insurance companies, pension funds, non-profit organizations, and faith-based institutions (Social Investment Forum, 2002).

History of Socially Responsible Investing

Socially responsible investing dates back to the late nineteenth and early twentieth centuries. The earliest expression of the concept came from religious institutions that chose not to invest in companies that made alcohol or tobacco products. In 1971, the presiding Bishop of the Episcopal Church presented General Motors Corporation with a resolution asking the company to withdraw from South Africa. This was the beginning of over twenty years of divestment in South African companies, primarily as an action to end apartheid. In that same year, the Pax World Fund was established by a group of Methodist clergy. This was the first mutual fund to screen for social issues (Kinder, Lyndenberg and Domini, 1992). Michigan State University was a pioneering public higher education institution when it adopted a South African divestment policy. Through these actions, SRI was catapulted into national attention.

Socially responsible investing is growing rapidly in markets across the world. In the United States in 2001, one in every ten dollars under professional management was subject to some form of SRI criteria (Social Investment Forum, 2002). The article 'Envisioning Socially Responsible Investing: A model for 2006' suggests that "socially responsible investing has emerged from an essentially obscure niche financial market to become a potentially important player in a major political debate about globalization, the relationship between corporations and society, and the role of capital in creating both social and financial value"(Lyndenberg, 2002). The Social Investment Forum's 2001 Report on Responsible Investing Trends in the United States showed that assets in socially screened investment portfolios grew 36 percent during the previous two-year period, whereas traditional funds grew only 22 percent (Most, 2002).

Domini Social Investments, an investment company located in Providence, Rhode Island, currently manages more than $1.2 billion in assets for individual and institutional investors interested in socially responsible investing. Its Domini Social Equity Fund is the nation's largest socially responsible index fund with over $920 million in assets. Another large well-known fund, the TIAA-CREF socially screened fund, has grown to well over $2 billion in recent years (Waddock & Graves, 2000).

Components of Socially Responsible Investing

Socially responsible investing has three key strategies: Social Screening, Shareholder Advocacy, and Community Investing. Each strategy plays a unique part in an overall investment strategy of an individual or an institution. Investors are able to choose any combination of the strategies to accomplish their investment objectives and social goals.

Social Screening is the process of screening the investment portfolio for companies that are deemed socially irresponsible. Some common social screens include nuclear power, alcohol, weapons, gambling, tobacco products, and repressive regimes. As of 2001, there were 230 mutual funds in the United States that incorporated social screening. According to the Social Investment Forum, a nonprofit organization that promotes socially responsible investing, 84% of socially screened portfolios exclude tobacco, 72%, gambling, 69% weapons and 68% alcohol.

Shareholder Activism is the process of investors influencing the practices of corporations with regard to social and environmental issues. Shareholder activism consists of both dialogue and formal shareholder proposals known as shareholder resolutions or proxy statements (Social Investment Forum, 2002). The goal of shareholder initiatives is to influence corporate policy by engaging management in productive dialogue on social and environmental issues. Resolutions typically direct a company and its board of directors to improve on some type of current social or environmental practice. Even if the resolutions are not passed, they may have an impact by bringing particular issues to the attention of the public and stakeholders. An example of shareholder activism is when stockholders divested in U.S. corporations doing business with or in South Africa during the 1970s and 1980s. In this case, shareholder activism is credited with helping eliminate apartheid. Another example is in 1997, when a shareholder resolution forced Time magazine to print their magazine on chlorine free paper (Schade, 2002). Also in 1997, Pepsico and Texaco companies divested their holdings in Burma (Myanmar) as a result of shareholder resolutions (Shareholder Action Network, 2002).

Community Investing is the practice of investing to create positive social change such as affordable housing, microenterprise and small business development, and other community development initiatives in distressed communities. Through community investing, investors directly place their funds in investments that earn a return that benefits communities. This can be done in various geographic areas, ranging from inner cities to rural communities. It can also be directed toward particular projects. The strength of community investing is that it has a direct and measurable impact in communities where investments are placed. Most community investments are accomplished through community based financial institutions such as microenterprise loan funds or community development credit unions.

Rates of Return

Those who administer endowments are required to demonstrate fiscal responsibility. For most investors this is understood to mean, "seeking the most prudent and highest rate of return." Over the last decade, a number of studies have looked at whether socially responsible investing impacts financial performance. Most of these studies have indicated that there is little or no difference between socially screened and unscreened investments. According to a study published in the winter 1993 issue of Financial Analysts Journal, socially responsible mutual funds do not earn less statistically significant returns and the performance of these mutual funds is not statistically different from that of conventional mutual funds (Hamilton, Jo and Statman, 1993). A similar study published in winter 1997 issue of Journal of Investing also found no significant differences in the mean returns of socially unscreened and socially screened equity investments for the 1987-1996 period. Over the last decade (1991-2001), the index run by KLD Research & Analytics Inc. posted annualized returns of 19.01 percent, while its comparable benchmark, the S&P 500 posted only 17.48 percent returns (Most, 2002). The recent performance of the market might suggest that a socially responsible investment plan may be a very sound investment strategy.

Data released in 2002 by Lipper, a global leader in supplying mutual fund information, showed that socially responsible mutual funds had their assets **increase** by 3 percent between January-June 2002, while conventional U.S. funds experienced a 9.5 percent **decrease** in total assets (Social Investment Forum, 2002). Lipper data also indicated that in June 2002, when the S & P 500 lost more than 13 percent, SRI mutual funds received net inflows of $47 million. Meanwhile, the quarterly mutual fund performance released by Social Investment Forum in July 2002 found that 13 out of the 18 screened funds with $100 million or more in assets tracked by the Social Investment Forum achieved the highest ranking from both Lipper and Morningstar (Social Investment Forum, 2002).

This evidence suggests that university and college trustees who have a fiduciary responsibility to maximize financial returns on their investments can achieve adequate returns through SRI funds. Universities set yearly goals as to the interest earnings they are attempting to earn from their investments. For instance, Michigan State University in 2002 was striving for a return of 10.9%. The percentage return that MSU strives for is reached by a historic analysis of investment performance. The university also takes into account inflation and its desired spending from its investments – currently 5.25% of the average market value of the endowment as calculated for the twelve quarters of the three calendar years prior to the beginning of the fiscal year (MSU, 2003). Since the rate of return is such an important aspect of investment decisions, investors often argue that the nature of socially responsible investing will lower financial returns, which would harm the university's long-term goals. Yet research has begun to consistently prove this argument wrong (Waddock & Graves, 2000; Guerard, 2002; Most, 2002).

University SRI Campaigns

Many socially responsible investment campaigns in higher education institutions grew out of the Vietnam War era, when many chemical and weapons companies were targeted for divestment because of their involvement in the production of war weapons (Schade, 2002). This was followed by the South African divestment campaign when Michigan State University, along with hundreds of colleges across the United States in the 1980s, divested from corporations having business interests in South Africa when apartheid was still being practiced. SRI campaigns have gained momentum in colleges over the past 20 years. The goal of these SRI campaigns is to encourage universities to adopt ethical standards in their multi-million or billion dollar investments. For instance, the University of Washington, Stanford, Tufts, and Haverford no longer invest in tobacco companies. The University of Wisconsin and the University of Minnesota divested from corporations with operations that support the military regime in

Burma (Myanmar). Yale, Harvard, Stanford, Portland State, Columbia, Brown, Cornell, and Tufts are among the many educational institutions with active committees on socially responsible investment (Students Transforming And Resisting Corporations, 2002). And Williams College recently developed a social choice fund for potential college donors, so that they can direct their investments to create social change, while benefiting the college.

However, while socially responsible investing through social screening is important, the results of these investments are only seen through indirect relationships. Whereas with community investing, investors actively create positive social change by addressing basic community needs such as affordable housing, new jobs, and key social services through investments in local community development organizations. Investing in low-income communities through vehicles like community development banks and community credit unions has the ability to create the needed financial capital to create visible short and long-term change. In return, investors receive a modest, but secure return on their investment. In addition, investors can eventually see a 'secondary' rate of return through jobs created, housing units built, and businesses developed. Each has the ability to improve their respective communities. By doing so, universities are potentially developing stronger communities from which they are likely to draw future students. Thus the benefit is seen both in distressed communities and on the university's campus. The benefits to a publicly supported higher education institution are obvious and significant. A healthy state economy directly translates into a positive general fund position for the institution.

Community Investing

One type of socially responsible investing is *community investing*. Community investing is the practice of investing in job creation, affordable housing, small business development, and other community development projects in economically distressed communities. Distressed communities need capital to survive, sustain, and eventually flourish. Financial capital is needed to construct, rehabilitate, acquire and refinance housing, to begin or expand businesses, and to construct or rehabilitate community facilities (Kinder, Lynberg and Domini, 1992). Community investments can provide some of this much needed capital. Community investing is emerging as the fastest growing component of socially responsible investing in the United States. According to a study done by Social Investment Forum, individual and institutional assets flowing into community investing organizations grew by 41 percent between 1999 and 2001 totaling $7.6 billion in 2001 (Social Investment Forum, 2002).

Options for Community Investing

Depending on the investment decisions made by an individual or the guidelines of an institution, there are three distinct options for community investing: direct investment, community investment portfolios and mutual funds (Social Investment Forum, 2002).

Direct Investment: Individuals or institutions can make direct investments in Community Development Financial Institutions (CDFI). These institutions range from small non-profit microenterprise lenders with a few hundred borrowers, to larger banking institutions such as the Self-Help Credit Union and Ventures Fund, which has 3600 borrowers and loans totaling $190 million (Freundlich, 2002). Typical rates of return for CDFIs range from 0-4 percent for terms of one to five years (Calvert Group, 2002). The following are five types of direct investment:

<u>Community Development Banks</u> (CDBs). These are local lending institutions that address community development needs. They offer the same kinds of services as conventional banks, but with the purpose of providing these products and services in communities that are underserved by conventional banks.

They are government regulated and provide banking services and loans to people who have difficulty obtaining market rate financing. They offer federally insured checking accounts, savings accounts, certificates of deposit (CDs), money market accounts, and individual retirement accounts (IRA) (Social Investment Forum, 2002). The South Shore Bank in Chicago is one of the oldest community development banks that supports community development efforts in the Chicago and Detroit metropolitan areas (Equity Trust, 2002).

Community Development Credit Unions (CDCUs). These are non-profit financial cooperatives that provide banking and loan services to financially disadvantaged communities. They promote local community lending and generally offer all traditional deposit products. They are easier to organize and hence are more numerous than community development banks. CDCUs make loans only to their members within their designated communities, but most of them do accept deposits from outside investors. Over 300 community development credit unions exist in low-income areas with total assets of more than $400 million. Deposits are typically insured up to $100,000. There are as many as seven certified CDCUs in Michigan.

Community Development Loan Funds. These are private, non-profit, unregulated and uninsured entities. They work with individuals and institutional investors to finance high-impact community development projects. Hundreds of loan funds are in existence. Though they are not insured, investments are protected through collateral, loan loss reserves, and a fund's net worth. They are more likely to net higher rates of return than other community investment options. Community development loan funds are also more flexible in making capital available for community development efforts than CDBs and CDCUs since they are not government regulated and as such offer a unique set of risks.

Community Development Venture Capital Funds. These are structured in a variety of ways including for-profits, non-profits, limited partnerships and limited liability companies. These funds are invested in equity investments in entrepreneurial businesses that have the capacity to create jobs and wealth in disadvantaged communities. They primarily provide startup capital for real estate and new business development.

Microenterprise Programs. These are programs that lend money to businesses with fewer than five employees that do not have access to commercial banking products and require loans of $25,000 or less. They are often uninsured, however they provide training, technical assistance, credit, and access to markets. There are over a dozen microenterprise programs located in Michigan. Two of the largest are the Northern Economic Initiatives Corporation in Marquette and the Lansing Community Micro Enterprise Fund. In general, there are few of these programs available to investors.

A list of nationwide community development financial institutions can be obtained from the website www.socialinvest.org.

Community Investment Portfolios: The second option for community investing is through community investment portfolios. With this option, investors can purchase a larger pool of CDFI investments through intermediaries and reach a number of different types of programs at once. Terms and rates are roughly similar to the CDLFs and CDCs they invest in, typically 0-4 percent (Calvert Group, 2002). The intermediary usually has a diverse portfolio of community investments and offers investors the opportunity to invest by targeting a region or specific sector.

Two examples of pooled approaches include the Calvert Community Investment Program and the National Federation of Community Development Credit Union's Nominee Deposit Program (Calvert Group, 2002).

Mutual Funds: The third option, socially responsible mutual funds, allows investors the opportunity to have an impact in communities while investing in a more traditional way. These mutual funds pool investors' money to buy a portfolio of securities. Overall they direct a portion of their assets to support community development initiatives. A few mutual funds have a community investment component built in. These assets are directed toward institutions under the direct investment option. They have the advantage of being very liquid, however, investors do not have control over the percentage of the mutual fund that is used for community investing. In addition, investors do not control the types of projects that are funded. They can however choose funds that target areas that investors are interested in. The Calvert Group, Domini Social Investments and Parnassus Investments are three of the larger providers of socially responsible mutual funds (Social Investment Forum, 2002). As an example, the Calvert Social Investment Fund is a mutual fund that seeks to provide an economic and social return to society that will contribute to the quality of life for all. The fund is invested in three types of community-based organizations: low-income housing funds, community development loan funds, and microenterprise funds. As of October 2002, Calvert Social Investment Fund had invested over $9 million in high impact social programs (Calvert Group, 2002).

Each of the three options for community investing presents benefits and disadvantages. Investors are usually advised to explore which option(s) best suit their investment needs and provides the desired impact in communities.

Secondary Rate of Return

One advantage of socially responsible investing and community investing is what is understood as the "secondary rate of return." That is, in addition to the primary rate of return, a socially responsible investor realizes "other" benefits from their investment portfolio. The secondary rate of return is often difficult to accurately quantify. It can be thought of in terms of jobs created, houses built, and community services provided. For example, an investment placed with any of Michigan's CDFIs would leverage significant other capital and provide financing for new affordable housing units or job creation through development of new small businesses.

A recently developed program at Harvard University, the 20/20/2000 program, has leveraged over $25 million for developing affordable housing in the cities of Cambridge and Boston. The program is essentially a $20 million low-interest loan fund that has so far created over 1700 affordable housing units in only its first 3 years (of a 20-year program). A 2001 study of the economic impacts of housing development concluded that building 100 multifamily units in urban Massachusetts would result in at least $5.73 million in income for residents, $1.15 million in revenue for state and local governments, and 120 jobs generated in the state. In addition to these immediate impacts, the expected recurring impacts of these 100 units included more than two million dollars in annual income, $834,000 in annual revenue for state and local governments, and 54 jobs (Kotval, 2001).

For universities that invest their endowments in communities, numerous secondary rates of return can be realized. For instance, local business development through community investing could create additional jobs for students in the form of part-time supplemental income, coop opportunities, and internships. It could also create a healthier, exciting community, one that can help draw students to attend the university initially and upon graduating, continue to reside in that community. Another example is the creation of affordable housing. Affordable housing development might enable more faculty to live near campus, which could also help create a more vibrant and stable community. Finally, stronger more stable communities with jobs and better housing provide the state with a better revenue stream which can indirectly benefit universities that receive support from state government.

A study commissioned in 2002 by the Community Investing Program of the Social Investment Forum entitled *CDFIs: Bridges Between Capital and Communities* found that community development financial institutions have a better pay back rate than commercial banks (Baue, 2002). The 107 CDFIs that were surveyed by the National Community Capital Association had a default rate of 0.5 percent, or about half the 0.9 percent rate of all commercial banks. This 0.5 percent rate is the same rate experienced by commercial banks with less than $100 million in assets. The study also stated that investors have never lost a penny of investment capital invested in CDFIs. The 107 CDFIs surveyed had sufficient equity capital bases and loan reserves to absorb any losses in their portfolios. The cumulative financing of the 107 CDFIs helped create or maintain almost 180,000 jobs, develop 147,000 housing units and helped advance 2500 community projects (Community Investment Program, 2002).

The Social Investment Forum is a national non-profit membership association dedicated to promoting SRI. It has developed a program called the "One Percent in Community" Initiative. This initiative was designed to encourage investors to move a total of one percent of actively managed social investment dollars into community investing by the year 2005. By diverting one percent of an investor's overall portfolio, it would have a minimal impact on the individual investor's overall returns, and the collective impact of a new influx of community investment dollars would make a powerful, lasting difference for people in disadvantaged communities. The fact that individual and institutional investors can achieve tremendous progress in communities with little or no impact to their portfolios through the Social Investment Forum's community investment initiative is a compelling reason for social investors to take action (Social Investment Forum, 2002).

Community Investing by Educational Institutions

Many would argue that educational institutions have a unique responsibility towards the society that nurtures and sustains them. By investing financially in communities, both local and statewide, a college or university can further its mission and act upon their public trust responsibility. Universities and colleges are in a position to create lasting change by altering their current investment practices.

At the same time, university officers have a responsibility to maintain the viability of each institution. They are responsible for providing current programs as well as regulating finances, both now and for the future. However, while they are often bound to maximize the financial returns of the university's investments, this does not preclude participating in community investment. Community investments can yield a modest but reliable financial return and a significant social return. This can be beneficial for the school in attracting donations from alumni and others donors who want to contribute to the development of their community. It can also lead to the revitalization of the same communities that it will recruit students from in the future. A case study of one such educational institution that has directed a portion of its investment towards communities follows.

The Williams College Example

Williams College is a private, residential liberal arts school located in the Berkshires in northwestern Massachusetts. It was established in 1793. The size of Williams' endowment was over $ 1.1 billion as of June 30, 2002. In October of 2001, Williams College announced the creation of a socially responsible investment fund, of which 10 percent is committed to community investments with the remainder in screened stocks. A two-year student campaign was primarily responsible for the creation of this fund.

It began in 1999 when a group of students realized that Williams had substantial investments in Phillip Morris, GE and other companies with questionable social and environmental behavior. Students sought to bring about positive change and questioned the responsibility of the college as a wealthy institution towards the depressed local community of Northern Berkshire County and other nearby communities. Community investment became a central component of their campaign. Resistance on the part of the college administration regarding investing a portion of the endowment in the community resulted in the students creating a separate SRI fund called 'The 2000 Fund.' This fund was developed outside the college with the help of Equity Trust, Inc., with donations from students, faculty, parents, and alumni who supported the concept. Equity Trust is a non-profit community development organization that provides technical and financial assistance to community-based economic development projects and organizations throughout the U.S. The money was invested in Equity Trust's community development loan fund with the intent that it would be invested in community.

As a result of the campaign, the college's administration decided to negotiate with the students as the 2000 Fund became popular and came to be seen as a threat to the school's usual fundraising efforts. After a series of meetings between the students and the administration, the Finance Committee of the Trustees agreed to create the Social Choice Fund at Williams (Equity Trust Inc., 2002). The bulk of the fund is invested in Calvert Group's Social Investment Balanced Fund. It was designed so that after the fund grew to $10,000 ten percent of the fund would be invested in community development loan funds with a focus on supporting the Berkshires (Baue, 2002).

Endowments – MSU and U of M

The University of Michigan system ($3.5 billion) and Michigan State University ($458 million) have the largest endowments in the state of Michigan. The composite amount of endowments of Michigan's 15 public universities totaled over $4.5 billion at the end of 2001 (HEIDI, 2002). Each university however, is guided by its own individual investment policy. These policies are subject to approval by each university's governing board. As a result of this autonomy, there is not a consensus as to how or where endowments should be invested. Each university chooses its investments, as well as asset allocation and endowment spending plan as it sees fit. Following is information about the endowments at Michigan State University and University of Michigan and their overall investment policies. It is reasonable to assume that each of the 15 public universities in Michigan follow similar guidelines, particularly relating to minimizing risk and maximizing return.

Figure 1. MSU's Endowment Profile

Source: MSU Investment Statement of Objectives (2003)

Michigan State University's Endowment

The endowment at MSU is guided by an investment policy that was most recently updated in June 2003. It is divided into nine sections outlining everything from the nature of funds invested in to the roles of investment managers, board of trustees, finance committee, investment consultant, university administration and investment custodians. This document spells out roles of individuals; however, each of these individuals must follow the university's fundamental investment principles and a statement of investment objectives. Those documents are the guidelines by which all university officials must follow when making investment decisions.

Michigan State University's endowment of $458 million is invested in the common investment fund. This overall fund consists of following three separate funds:

- Institutional funds that cover long-term investments, which can include both retirement and endowment funds.
- Annuity and life income funds as permanent investments.
- Institutional cash (MSU, 2000).

The endowment is invested in the first of these funds.

The investment objectives of the Common Investment Fund are to provide a total rate of return sufficient to satisfy annually the amount to operate University's programs supported by endowment funds and achieve the desired return while bearing a moderate amount of risk (MSU, 2000). In simple terms, the university hopes to maximize its return while making safe investments. In doing so, it hopes to provide continued support for university programs, be it funding for scholarships, faculty salaries, or facilities. Review of other university investment objectives shows similar desired outcomes.

In addition, at Michigan State University there is a prescribed asset allocation as determined by the Board of Trustees with input from investment consultants and the Trustee's finance committee. The purpose of asset allocation is to minimize risk and provide a desired rate of return by investing in various classes of investment such as common stocks (U.S. and/or foreign), inflation hedges, private equity, fixed income and absolute return. For each asset class there is a target percentage, which is within a range of percentages. This allows the university to adjust its investments accordingly, particularly when market conditions change. Beyond the asset allocation, the university adopts short-term and long-term goals, which it compares to market benchmarks to determine its investing performance. Fig I. shows the target asset allocation of Michigan State University's endowment.

University of Michigan's Endowment

The University of Michigan (U of M) endowment fund is 13th largest of U.S. higher education

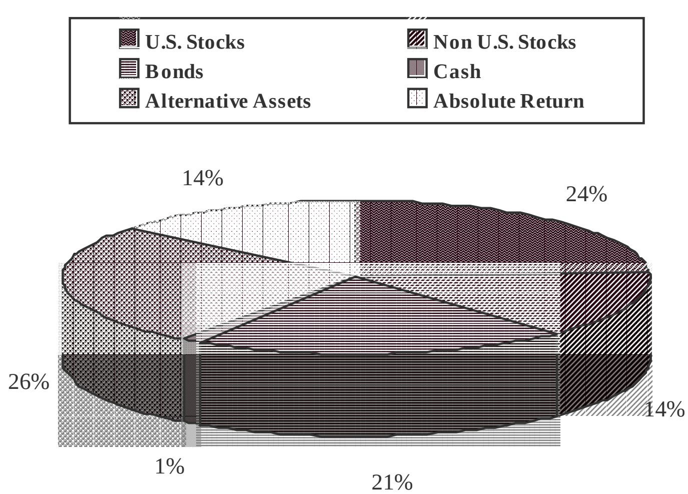

Figure 2. U of M's Endowment Profile

Source: U of M-University Endowment Fund Profile. June 30, 2001 institutions and the 4th largest among U.S. public university systems (NACUBO, 2003). It has grown to its current size of $3.5 billion through an investment strategy of managing risk while maximizing return.

The endowment at U of M is divided into two types: true or permanent endowment and quasi-endowment. The true or permanent endowment consists of funds that come from outside donors and the principal is invested in perpetuity with only a portion of interest being spent annually. These distributions must be used in accord with the donor's desires. The quasi-endowment consists of funds that come from either outside donors or internal funds in which the principal is available to be spent as the institution sees fit (DP, 2000).

U of M's endowment is organized similar to a mutual fund, which is somewhat different than MSU. It has an overall endowment pool that includes the balances of both the true and quasi endowments. Money that is placed into an endowment account will buy shares in the endowment pool at the share value, which is determined quarterly. On average, the increase in the value of a share at U of M is proportional to the increase of the value of distributions. It has also increased steadily in over the past five years. For example, the share value for the University of Michigan endowment in June 1997 was approximately $2.20, and by June 2001 it had increased to almost $7 per share (Office of Development, 2001). Much of the increase of share value can be attributed to university's assets allocation and the policies regarding the hiring of investment managers.

The University of Michigan's endowment investments are quite diversified and hence, the investment risks are significantly lower (UM, 2001). However, in the transition from the fiscal year 2000 to 2001, the University of Michigan's endowment lost almost $180 million due to the volatility of the financial markets. Nonetheless, it re-affirmed the conviction of the University of Michigan administrators and Board of Regents to look for long-term alternatives of re-investments. University of Michigan's endowment is composed with the following profile: 24% U.S. stocks, 14% non U.S. stocks, 21% bonds, 1% cash, 26% alternative assets (venture capital, private equity, real estate, energy investment) and 14% absolute return (emphasizing manager skills rather than market movements) (OD, 2001). Figure 2 shows the asset allocation of U of M's endowment.

It is important to note that the University of Michigan has a significant diversification of alternative assets and absolute returns. As a rule, it invests 40% of its total long-term investment policy in alternative assets, most likely because they are not significantly dependent on the volatility of the stock markets.

Potential impact of using endowments for community investing

Much of the community investing done by various institutions and individuals is through alternative asset allocation. This allows investors the ability to make a social impact, while earning potentially larger returns with riskier and more traditional investments. The potential for social impact would be greater however, if each of Michigan's public universities chose to allocate a portion of their endowment investing in community investments, such as the Adrian Dominican Fund, the McGehee Fund, or bonds issued by the Michigan State Housing Development Authority (MSHDA) . For example, if U of M invested 1% (as proposed by the Social Investment Forum for all investors) of their alternative assets into community redevelopment, this could result in a total of $9.1 million invested in Michigan communities. Similarly, if Michigan State University invested 1% of its alternative assets (approx. 20% of total asset allocation) in communities, this would amount to $916,000.

On a larger scale, if each of the 15 public universities invested 1% of their alternative assets in community investments (assuming each university has 15-25% placed in alternative assets), it would infuse as much as $11.5 million into communities to create jobs, develop affordable housing and rebuild distressed neighborhoods. The impact for Michigan would be significant. For example, $10 million invested in Michigan for a period of 5 years would create 867 new affordable housing units, 4,500 new microenterprises, 700 new small businesses, or more than 4,000 new jobs (Calvert Group, 2002). Over time, community investing could have a lasting impact that benefits both distressed communities in Michigan and all of Michigan's public universities.

Analysis and Recommendations

Socially Responsible Investing is increasingly being practiced across the nation by both individual and institutional investors. A number of well-respected universities and colleges have incorporated SRI policies for their endowments. However, few private or public educational institutions have a community investment component in their SRI policies. In this regard, Michigan State University and other Michigan universities can lead the way by becoming some of the first public universities to invest a portion of their endowments in community investment vehicles like Community Development Financial Institutions and community development banks. There are many reasons why MSU and ultimately other public universities should adopt a community investing as part of their overall investment strategy:

- Community investing can further the university's mission which states, "MSU is committed to contributing to the understanding and the solution of significant societal problems."
- MSU is a public university and receives subsidies from state government and other forms of public financing. Utilization of these public resources implies that there is an awareness of responsibility toward public needs including the needs of under-privileged members of the society.
- Michigan State University has initiated a major capital campaign. A community investment policy has the potential to attract additional donations, particularly from people who feel strongly about ethical investing. This could ultimately assist the institution, and others, in achieving donor campaign goals.
- Community investing yields modest, yet reliable financial returns while maximizing the use of investment funds. In return, it provides a significant secondary rate of return by providing affordable housing, creating jobs, and developing small businesses.

Just as the university is cautious in developing an overall investment policy, it should also be methodical in implementing SRI as part of that policy. MSU could easily develop guidelines regarding socially responsible investing, with a focus on community investing.

One potential scenario for the university would be to form a committee to further explore how it can promote its mission of solving societal problems through community investing. The committee's goals would be to work with the Board of Trustees, investment managers, and consultants to develop a SRI policy that complements the university's current investment strategy. The committee would be composed of a group of representatives across campus including students, faculty, staff, university officials, and community representatives. It would develop guidelines regarding how community investing is accomplished at MSU, including investment options (such as through CDFIs or CDBs), geographic targeting for community investments, and the type of impact the university would ultimately desire (building affordable housing or providing small business loans for example). This is how many universites and colleges have entered the SRI and community investing domain.

A second possible scenario is for the university to adopt socially responsible investing, particularly community investing, as part of its current investment strategy. It would be prudent to suggest that the only a portion of the Michigan State University endowment be used for socially responsible investing and community investment strategies. The investment managers who are hired by the board of trustees look for investments that tend to be lower risk, with a steady rate of return in many asset allocations. They could utilize a portion money invested in fixed income, absolute return or possibly inflation hedges. Investing a portion of one of these asset allocations opens the door for community investing and socially responsible investment policies as a new strategy to gain a solid rate of return and while contributing to the overall well being of lower income communities throughout the state. These investments could be made in community development financial institutions like the Michigan Housing Trust Fund, in community land trusts, or various microenterprise programs. MSU could also invest in socially responsible mutual funds with a community investment component like the Calvert Social Investment Fund, the Domini Social Equity Fund, or the New Alternative Fund. However, it is important to note that investing in mutual funds does not have the same impact as direct investments in community investment vehicles like CDFIs, since only a very small portion of each dollar goes toward community investments within each mutual fund.

Regardless of the path that Michigan State University, the University of Michigan, or any of the other 13 public universities decide to pursue regarding investment decisions for their endowment funds, it is time for them to seriously consider investing in communities that need financial resources to flourish. The risk can be minimized and the rate of return can be comparable to some current investments; the impact community investing could have on rebuilding communities in Michigan could be significant. With all of the renewed calls for civic engagement in the past years, the time is ripe for universities to truly become fully and financially engaged with communities. Edward M. Hundert, president of Case Western Reserve University summed it up well at a recent conference when he said, “The city and university cannot thrive without each other. Both must work together to build real solutions to the problems we confront in these extraordinary times.” Community investing provides the opportunity to build these solutions.

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Selected Web Resources on Community Investing

Calvert Group, Bethesda, MD, www.calvert.com

Calvert Foundation, Bethesda, MD, www.calvertfoundation.org

Community Development Venture Capital Alliance, New York, NY, www.cdvca.org

Domini Social Investments, Providence, RI, www.domini.com

National Community Capital Association, Philadelphia, PA, www.communitycapital.org

National Federation of Community Development Credit Unions, New York, NY, www.natfed.org

National Housing Trust Fund, Washington D.C., www.nhtf.org

Shore Bank, Chicgao, IL, www.sbk.com

Social Investment Forum, Washington D.C., www.socialinvest.org

Social Investment Forum Foundation, Washington D.C., www.communityinvest.org

SRI World Group, Inc., Brattleboro, VT, www.socialfunds.com

Students Transforming and Resisting Corporations, Portland, OR, www.starcalliance.org

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