Submission

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Philanthropic Foundations Canada
Fondations philanthropiques Canada

- *Philanthropic Foundations Canada is a national association with 132 members, including public and private foundations and other grantmakers.*
- *Our members held over $23 billion in charitable assets at the end of 2015.*
- *PFC members made grants of $532 million to Canadian charities in 2015 and disbursed over $346 million in foundation-managed charitable activities*

Summary

Philanthropic Foundations Canada (PFC) is a Canada-wide membership association of charitable grantmakers, including public and private foundations as well as corporate giving programs. Our mission is to promote the growth of effective and responsible foundations and organized philanthropy in Canada. The funders we represent contribute significantly every year to the wellbeing of Canadians and their communities through grants and investments in education, health facilities, social services, arts, sports, youth programs and other supports that help Canadians and their families to lead better lives.

Our members work primarily through registered Canadian charities to achieve their charitable objectives. Grantmakers believe that it is important to enhance access by Canadian charities to capital that will enable them to innovate, grow and increase their effectiveness. Currently, the Income Tax Act and regulations constrain the ability of foundations to provide capital to charities or non-charities with a social purpose, except under limited conditions. In particular, the rules governing so-called program-related investments are unclear and constirning. As private funders, we encourage the government to clarify and to broaden these rules.

Financing the Charitable Sector

Public and private foundations in Canada contributed about $5.6 billion in grants to Canadian charities in 2015 according to the Canada Revenue Agency. Typically, foundation grants permit charities to start a new program, try an unproven approach, carry out a strategic initiative or make an investment for growth. However, donations from individuals and foundations combined do not contribute more than 10% to 15% of the financing available to the sector. Research by Imagine Canada suggests that the so-called structural "social deficit" (or gap between services demanded and revenues available) faced by charities will only accelerate over the next few years

Back in 2010, the Canadian **Task Force on Social Finance** noted that "social finance offers an unprecedented opportunity for Canada's charities and nonprofits to open up new sources of financing at a time when many are trapped in a cycle of short-term subsistence funding that diverts attention from their mission and impact, inhibits innovation, prevents them from expanding solutions that work, and threatens their sustainability." In 2011, the Task Force repeated its call for action to develop social finance markets, suggesting that "the case for building Canada's impact investing marketplace is more compelling than ever… Given fiscal and societal pressures, we need to unleash the innovation capacity of all Canadians — including those in the social sector — and work together to develop effective, impactful solutions. Social finance is an essential part of building and sustaining this critical innovation engine in Canada."

Private funders can be important catalysts for social innovation and entrepreneurial activity in the nonprofit sector. We believe that we are at a tipping point for impact investing by foundations in Canada. A growing number are using this approach to support organizations and projects that share their mission. They are investing more capital to address issues such as sustainable food production, renewable energy and adjustment to climate change, affordable housing – to name a few – while also making a financial return.

Many pioneering community, family, and independent foundations are well out of the gate with sophisticated strategies to build impact investing into their organizational practice. They have shared, learned, experimented, and re-invested. This wave of early adopters has cleared new ground for others to participate.

Canada's 10,000 public and private charitable foundations, with combined assets of close to $40 billion, could be important investors when it comes to building needed social purpose ventures in Canada. More and more foundations are moving to set aside of anywhere between 5% and 10% of their portfolios for such investments. And the market is growing.

We know that Canadian charities continue to have unmet need for debt finance and investment capital, to finance their facilities, bridge finance the acquisition of equipment, invest in "soft" capital such as business plans or human resource development and otherwise finance their growth. This is particularly true for the smaller charities. While debt capital is available from commercial institutions, the smaller organizations with multiple and unpredictable sources of revenue do not access it easily. There is a gap for unsecured debt for working and growth capital in smaller amounts. Loans and investments from foundations can help to bridge this finance gap for small and medium sized charitable and non-profit organizations. Federal encouragement of this activity will be of great benefit to many of them without incurring any significant fiscal cost to government.

Why impact investing?

Impact investing complements the mission-related impact of grantmaking. Through impact investments, foundations can target positive social and environmental impact alongside a financial return. This approach has a range of benefits. For example, foundation endowments could, among other things:

- Support small scale social entrepreneurs;
- Grow the stock of green, urban, and social infrastructure like affordable housing that our cities and communities need;
- Help charities with capital needs and cash flow challenges;
- Support the switch to sustainable energy;
- Bring mission-aligned capital into partnerships with government and the private sector;
- Aim capital towards gaps in financing, such as for newcomers to Canada, Indigenous communities, and women; and
- Work at bigger scales and over longer terms.

Canadian foundations already investing for impact

A number of foundations are already making mission-related investments in companies that operate in socially responsible ways or that work directly in fields of interest to them such as health care or environmental management. A few are experimenting with making program-related investments (PRI) which are typically loans made directly to charities and can be made at below market rates. For example, a private foundation has provided financing for a $10 million mortgage to an education charity to finish construction of educational facilities at below market rate interest rates (and interest repayment deferred to end of the 5-year mortgage). In another example, a private foundation made a loan to a human services agency to purchase a transitional house, with initial value of $200,000, repayable without interest over twenty-five years, secured by a caveat on the title. These loans are often made for housing and real estate investments because they have market valuations.

In another example, the Lawson Foundation of London and Toronto, starting with a 3% goal for its assets invested for impact, has built a portfolio of investments, including a significant purchase of a community bond offered by Innovation Works in London, Ontario and a co-working space for a variety of charities and social enterprises.

Meanwhile, the Ottawa Community Foundation is supporting affordable housing in Canadian cities through a $1 million equity investment in New Market Funds and an equal commitment to the Community Forward Fund, which makes loans to non-profits.

Closing the gap

Despite this activity and momentum, it's clear that we still at the starting gate. A majority of Canadian foundations have not yet set targets for investing their capital for impact. There is pent up interest in practical steps and advice to help foundations engage. Last fall, PFC and Community Foundations of Canada sponsored the preparation of an online **impact investing guidebook**, with the help of Purpose Capital. And many foundations are taking advantage of these advisory tools to begin to move forward.

However, most foundations do not have the expertise or the resources to make and manage loans directly even though they wish to allocate some of their capital to this activity. They encounter barriers due to lack of internal capacity to perform due diligence on loan or investment opportunities, lack of size to meet the thresholds required for some social investments, and restrictions on their ability to provide loans to non-charities. For these reasons, foundations need more intermediary organizations to facilitate the capital flows. One such intermediary is the Community Forward Fund, established as a limited partnership with private funds to make loans and to provide financial advice to charities and nonprofits. The CFF is not a registered charity which makes it impossible for foundations to provide grant support to it directly. Federal regulators are now allowing private foundations to invest in such structures by buying a limited number of LP units. But limits do remain on the ability of private foundations to directly support non-charitable structures that could increase capital flow to the sector.

What are Regulatory Barriers to Growth?

Federal and provincial statutes concerning charitable investments emphasize that charities must undertake only those investments prudently made with a secure expectation of return (for example, a secured mortgage loan at market rate to a housing corporation). The Canada Revenue Agency is of the view that investments made by foundations at below market rates to non-qualified donees (for example, non-profit organizations) are in fact prohibited gifts.

To provide a relevant example related to the discussion of opening up access to capital, we note that a nonprofit loan fund structured as an incorporated nonprofit would not be able to access foundation capital at less than market rate because it is not a qualified donee. This rule has limited the establishment and growth of nonprofit financial intermediaries. Such intermediaries cannot register as charities under the *Income Tax Act* definition of charities, although intermediaries that provide philanthropic venture capital to other charities have flourished under the broader definition of charity now found in the United Kingdom.

To create a facilitative regulatory regime for charitable funders who wish to provide more of their capital in the form of loans and investments in charities and non-profits, it would be helpful if the CRA established a clear set of guidelines regarding **program-related investing** (loans to charities and non-profits or below market-rate impact investments by foundations).

This type of program-related investing or PRI has had little regulatory recognition other than in a CRA policy guidance document on community economic development (CG-014) first published in 1999 and revised in 2012. While the revisions in 2012 were helpful in defining PRIs and in clarifying that foundations can make PRIs even to non-profits if agency rules are followed, the regulations are still not entirely clear and their requirements for direction, control and reporting are a disincentive to the use of these mechanisms especially by smaller foundations. The guidance on PRIs could be set out more broadly so that it is not embedded in a document on community economic development but established as a tool that can be used for any recognized charitable purpose or, more broadly, for public benefit, pursued by a registered charitable foundation. The requirements for direction and control of funds, and rules on reporting should also be reviewed to ensure that they are proportional to the risk incurred and to the capacities of the smaller lenders. At present, these rules are overly onerous and restrictive to charities and their agents. If these changes could be made, we believe that we would see a greater flow of philanthropic funds to organizations with a social purpose, often those that can contribute most to the badly needed innovation that we seek for Canada's social and community sector.

Thank you for your consideration.