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INCORPORATED

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Financial Institutions in Community & Society

Current Practices and Future Opportunities

Fall 2005

Background & Acknowledgements

This study grew out of a research and development method created by Marga Incorporated's founder, President, and CEO, Dr. David J. Maurrasse. As a mission-driven organization, Marga's purpose is *to maximize existing resources for societal gain.* Within this resource-maximization framework, the essence of Marga's R&D method is to:

- Gather data and case studies from a particular industry;
- Assess the state of that industry's role in society and community partnerships;
- Write and analyze the variety of findings;
- Stimulate dialogue and thinking about the findings within and outside of the industry;
- Develop services that can assist the given industry in becoming more effective;
- Pilot these services with a few select institutions, and
- Refine and continue to apply the service.

This was the path that led to the development of Marga Incorporated's services for institutions of higher education. Marga takes an industry-specific approach to finding the most appropriate ways for institutions to make their resources available in addressing societal concerns.

Richard S. Greenberg, Marga's Executive Vice President, served as the principle investigator on this research, which focuses on the state of the financial services industry's community and societal engagement. Martha Tam and Cynthia Jones, Marga Senior Consultants, served as financial analysts and guided the research's quantitative methods. A number of interns worked with Greenberg and Maurrasse in developing a survey instrument, conducting interviews, and analyzing the findings, including Ben Clausen, Alnisha Howard, Natalya Koyenova, and Brooke McDowell.

Marga Incorporated is grateful to all of the financial services institutions and nonprofit service providers that agreed to participate in this study, including Bank of America, Citigroup, Credit Suisse First Boston, Deutsche Bank, Goldman Sachs, Independence

Community Bank, JP Morgan Chase, M&T Bank, Merrill Lynch, Morgan Stanley, Valley National Bank, Wachovia, and Washington Mutual. Their participation demonstrated the willingness of these institutions to get better in their community relations and philanthropy. We also wish to acknowledge the nonprofit organizations that assisted us in this work, such as the Abyssinian Development Corporation, CityKids Foundation, and Wall Street Volunteers. Marga Incorporated hopes that we can make a meaningful contribution to maximizing the range of existing resources within the financial services industry toward the improvement of society.

Finally, extra special thanks to Citigroup for providing us a forum in which we could release the findings of this report.

Context and Rationale

The world is getting smaller. With each passing day, as boundaries dissolve and technologies converge, society becomes more interconnected. Today, society's building blocks – communities and industries – are more interdependent than ever before. In response to this convergence, industries are reexamining their roles in society and reevaluating how they can connect with their respective communities.

The financial services industry exists at the nexus of this convergence, as the industry requires an efficient flow of information and unfettered access to markets. Given that boundaries are contrary to this flow and access, it is in the best interest of financial services institutions to continually assess their community access points and related information flows and adapt accordingly.

This 21st century context drives the research rationale and informs the report's findings – that is, increasing interconnectedness and the associated opportunities for mutual gain. As globalization and the digital communications revolution accelerate the pace of convergence, win-win scenarios are more readily accessible, and profitable, than ever before. Economists refer to such upside-only opportunities as Pareto Improvements: any change in society that makes at least one party better off without making any party worse off.

Indeed, this is the essential opportunity that the financial services industry faces today. By forging strategic partnerships with their communities, financial services institutions can realize Pareto Improvement gains that simultaneously grow their bottom lines and enhance community well-being. Simultaneous financial and social value can be forged thanks to the magic of mutual gain partnerships that move beyond the limiting constraints of zero-sum thinking. As community-builder Angela Glover Blackwell observes, "We must be building those mutual gain relationships, finding the language to speak to business…crafting win-win scenarios becomes essential."

A closely related outgrowth of these convergence trends is the reconceptualization of the value of those who have historically been perceived as the passive 'external other:' low-income populations. As C.K. Prahalad points out in *The Fortune at the Bottom of the Pyramid*, consumers who were once relegated to charitable, or at best marginal, status have become coveted customers to connect with, markets to penetrate. Consequently, the world's leading financial services institutions are more attuned than ever to the importance of understanding and connecting with their communities – because it's the right thing to do, but also because it's the profitable thing to do.

Mutual gain, however, is not easy to accomplish in practice. Success requires strategies informed by the new realities of today, guided by cost-benefit tools grounded in both community priorities and business imperatives. In order to succeed over the long-term, these strategies must become *central to core business operations*, not confined to charitable and public relations functions. In a recent *Economist* article ("What Is the Business of Business?" 5/26/05), Ian Davis makes the case for building social issues into strategy:

> Large companies must build social issues into strategy in a way that reflects their actual business importance. Traditional corporate social responsibility is often defensively geared toward rebutting criticism and tends to operate at a distance from strategic decision-making within the company, and thus is limited as an agenda for corporate social action because it fails to capture the importance of social issues for corporate strategy. It can help to view the relationship between business and society as an implicit social contract that has obligations, opportunities, and advantages for both sides.

Perhaps most promising for the actualization of mutual gain, the financial services industry is coming to appreciate the power of communities to serve as learning laboratories and idea innovators. As a result, what were once the 'external acted upon' are being transformed into valued participant agents. In *From Spare Change to Real Change*, Rosabeth Moss Kanter writes, "Traditionally, business viewed the social sector as a dumping ground for spare cash, obsolete equipment, and tired executives. But today smart companies are approaching community as a learning laboratory. Smart companies view community needs as opportunities to develop new ideas, serve new markets, and solve long-standing business problems."

Applying Kanter's logic to the arena of financial services philanthropy, charitable hand-outs may gradually become outdated. The most enlightened financial services institutions can evolve beyond traditional grantmaking to adopt a more sophisticated framework of making social investments. This philanthropic shift provides a compelling example of the breaking down of artificial boundaries, as financial services institutions grasp the logic of treating community organizations as they would other potential investments – and subsequently measuring social return on investment (SROI). Ultimately, the emerging SROI yardstick may prove to be the most powerful driver of the industry's evolution vis-à-vis community and society.

The research herein seeks to demonstrate pathways for making mutual gain a more commonplace reality. As the collected practitioner knowledge and analysis reveal, financial services institutions, by striving *to maximize their existing resources for societal gain*, have already taken the first steps down this path. It is hoped that this report, and the dialogue and experimentation it stimulates, will move the industry further down the path of mutual gain and illuminate the promise of creating only winners.

Trends and Promising Practices

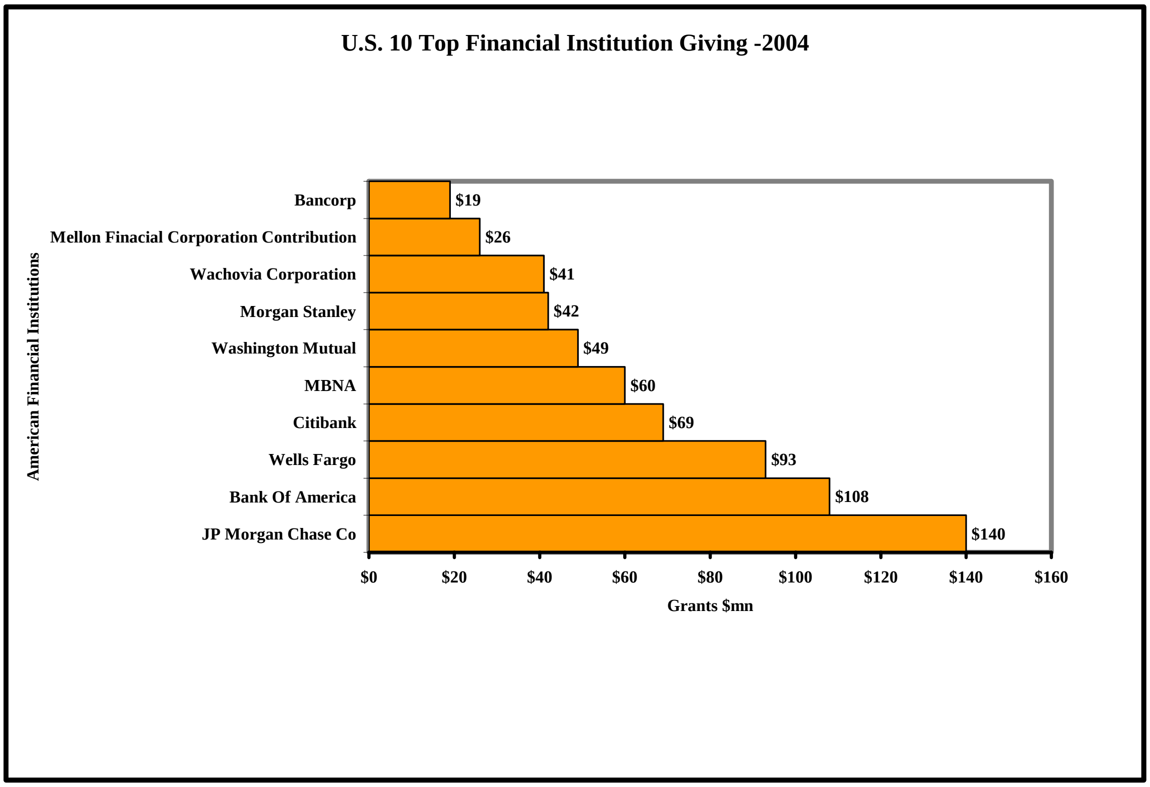
The context in which the financial services industry sits provides the foundation for expanded commitments to community partnerships. Populations that were once ignored by the industry have become a focal point of marketing the "unbanked." The idea of soliciting people at all socioeconomic levels to utilize bank services is a critical growing trend. Another interesting trend in the backdrop of the growing interest in newer markets is the overall effort of financial institutions to manage monetary transactions, previously conducted outside of banks. Remittances, for example, have been traditional ways in which immigrants have sent funds back to their home countries, through an informal, but substantial, global market. The financial services industry has taken note of this trend, especially as boundaries between nations wither, yet national identity among immigrants remains high.

This is all to say that banks are expanding their markets by reaching out to new communities. As a result, relationships between banks and immigrants, rural peasants, low income urban service workers, and on are forming. These are formal transactional relationships that reside within the core business of these banks. This is not extra, or charitable; it is inherently beneficial to the banking industry. And, indeed, these new relationships spawn interdependency. As financial institutions covet the business of these communities, they must strive for positive relationships with them.

As a result, financial services institutions have begun to move down the path of mutually beneficial community partnerships. Indeed, the range of ways in which institutional resources are being applied to engage communities is diverse. Regardless of the specific form, all of the profiled initiatives in this report share the purpose of building mutually beneficial partnerships between the industry and communities. Within this broad context, the research addresses two primary questions: 1) What are some notable initiatives and trends by which financial services institutions engage community and society? 2) How can these existing initiatives, as well as new philanthropic approaches, be as strategic and effective as possible in a manner that maximizes returns for financial institutions and society?

In many ways, particularly over the past two decades, the financial services industry has been at the forefront of the community revitalization movement – thanks to the wealth of human and financial resources they can leverage to affect social change. Investment levels of financial institutions in social issues and community programs remains relatively robust:

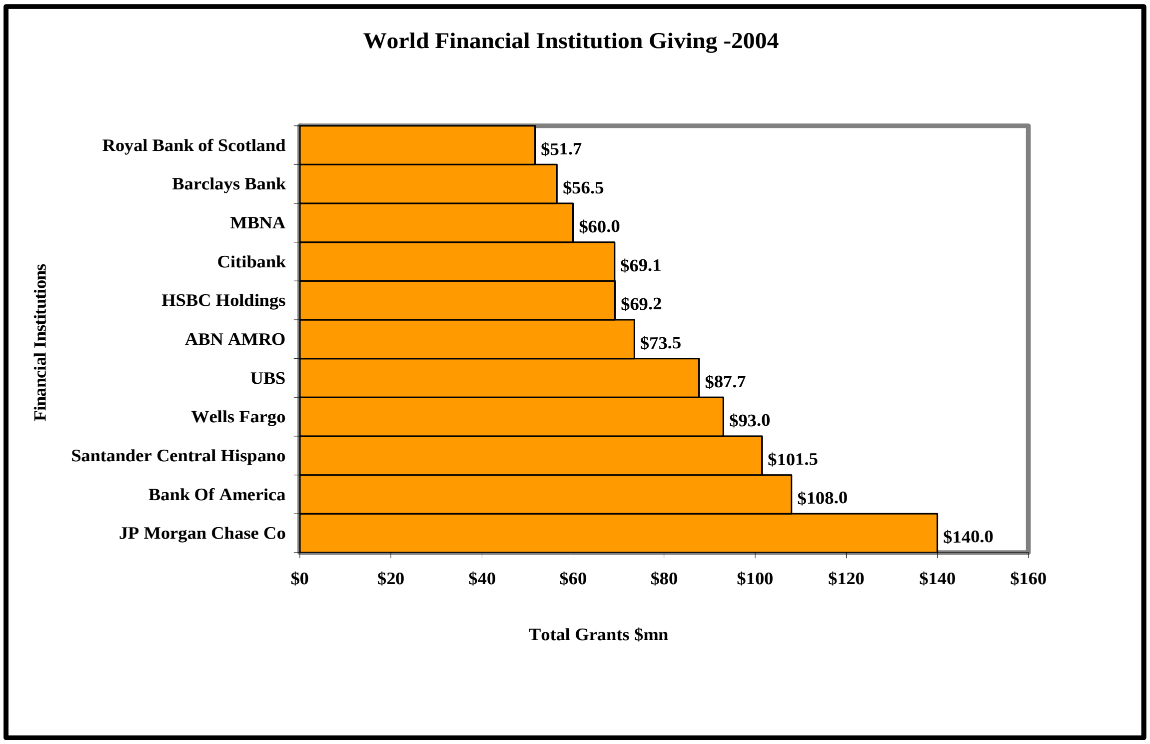
Figure 1:



Source: Financial institutions 2004 annual reports and IRS files.

Figure 1 shows only US Financial Institutions global giving in the year 2004.

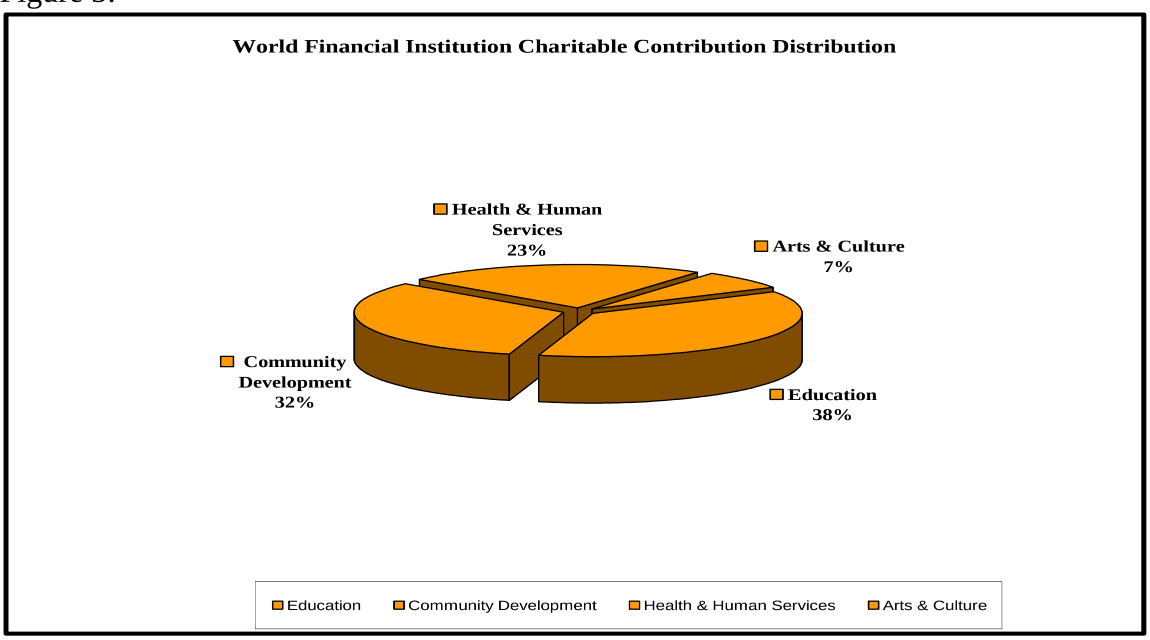
Figure 2:



Source: Financial institutions 2004 annual reports and IRS.

Figure 2 shows US and international financial institutions global giving in the year 2004.

Figure 3:



Source: Financial institutions 2004 annual reports.

Figure 3 shows World financial institution charitable contribution distribution in 2004.

Note: Charts 1 through 3 only include financial institutions for which there was available information.

Not surprisingly given this increasingly sophisticated track record, the research reveals a growing awareness among financial services institutions as to the value of community engagement. The more salient question appears to be *how*, not *if*. "We understand that we are obligated to act in socially responsible ways, and that both the firm and our communities benefit as a result, and so we do, enthusiastically," says Eileen White, Director of Charitable Services at Goldman Sachs. "The question we are constantly asking ourselves is *how*: what are the most effective vehicles for achieving high-impact, win-win community engagement?"

To help answer this fundamental "how" question, financial services institutions are actively experimenting with a variety of community engagement "vehicles." In aggregate, the research data indicate that promising practices concentrate in three emergent clusters: 1) employee engagement, 2) capacity building, and 3) community development.

Employee Engagement: Humanizing and Enriching Community Partnerships

Just as communities consist of individuals, so too do institutions. Employee engagement, building connections among communities and institutions through hands-on civic volunteerism, takes advantage of this cardinal rule of organizational theory (that every organization is but a collection of individuals, financial services institutions included). Connecting the dots at the individual level humanizes potentially anonymous partnerships. Eric Eckholdt, President of the Credit Suisse First Boston Foundation, gives voice to this simple truth, rhetorically asking, "If the goal is to connect our firm with our community, and vice versa, what could be better than having our employees leave their desks and get out there and do something real?"

Indeed, financial services institutions have discovered that one of the most effective ways of forging sustainable community partnerships is to provide clear, readily accessible avenues for their employees to share their personal skill sets and actualize their desire to 'give back.' Communities benefit from the direct interaction with motivated, skilled employees who volunteer with official institutional endorsement on their side, including firm mandates and paid leave. From the institutions' vantage point, employee participation in community service projects builds morale and enhances culture, reinforcing the business values of teamwork, camaraderie, and loyalty. Over time, employee engagement serves as a powerful engine for institutionalizing community partnerships on a firm-wide scale, as this face-to-face collaborative vehicle builds countless relationships that humanize and enrich the institution-community interface.

In 2005, between 15,000 and 16,000 **Goldman Sachs** employees will participate in Community TeamWorks (CTW), a "global day of service" wherein Goldman employees work together in teams within communities, in tandem with nonprofit service providers, to support under-resourced populations. Through the CTW program, nearly 700 nonprofits and their respective constituents worldwide gain from Goldman employees' skills and expertise. Marilyn Duffy, Vice President of Charitable Services, explains, "Community TeamWorks is a statement of the firm's commitment to the community, both here and abroad. In practical terms, it is a means for Goldman to engage communities in tangible, meaningful ways that our employees can see and feel."

Casey Karel, former Director of the **Credit Suisse First Boston** Foundation, believes that the creation of "living, breathing relationships" between CSFB employees and their communities is essential to maximizing programmatic impact. To realize this engagement objective, in 2005 CSFB has initiated a philanthropic strategy wherein community partnerships are, "contingent upon employee volunteerism opportunities." By applying a model that both institutionalizes and mandates employee engagement, CSFB is also seeking to gauge community needs more accurately by "getting out there, rolling up our sleeves, and listening," while enhancing its own culture in the process. Eric Eckholdt, President of the CSFB Foundation, remarks, "We think it's important for CSFB to interface actively with communities that represent both our employee and customer bases, because it's good citizenship and good business."

Each summer at **JP Morgan Chase**, under-served young people ages 14-21 intern at the firm in a variety of capacities. As part of JPMC's seven-week Summer Employment Program, youth from throughout New York City build their skills and the firm's employees have the opportunity to share and learn. Business etiquette, how to dress and speak in a professional environment, and specialized business training are among the topics addressed in the program. Karen McGuinness, Vice President of Community Relations, remarks, "We want to make a practical difference in the lives of the young people who participate in our Summer Employment Program, so we position our employees to impart skills and lessons that the young people will be able to apply throughout their careers." Many young people who successfully complete the program receive offers of full-time employment at JPMC. McGuinness notes, "It's a powerful way to forge mutually beneficial community ties that live beyond a predetermined grant or program cycle and so, over time, help to erase boundaries between JPMC and the communities that surround us."

On the other side of the table, in response to the growing employee engagement trend, nonprofit organizations are striving to provide readily accessible pathways to pave the way for this increasingly prevalent partnership vehicle. The following two initiatives provide examples of how employee engagement can be externally catalyzed.

Founded in 2004, the mission of **Wall Street Volunteers** is to promote and facilitate volunteerism among its members and, long-term, to cultivate a sense of civic responsibility within the next generation of Wall Street leaders, creating individuals with lifelong commitments to the nonprofit community. Josh Tarasoff, WSV's founding Executive Director, explains, "Our guiding assumption is that busy young professionals possess a latent desire to give back to the community, but are often deterred from taking the first step because they do not know where to begin. At the same time, there are a variety of compelling volunteer programs and outstanding junior board positions at New York City's best-run nonprofit organization." This situation constitutes an inefficiency — one that WSV addresses by connecting members with New York City nonprofit organizations that need them.

In the spring of 2005, **The CityKids Foundation** and Marga Incorporated jointly launched Private Sector Partners (PSP), an employee engagement vehicle intended to forge mutually beneficial partnerships between public service institutions and the banking community. To commemorate PSP's launch, Marga and CityKids – a NYC-based youth development organization – hosted a launch event in Manhattan in May 2005. The attendees present embodied the potential of such employee engagement initiatives to forge community partnerships, as the evening brought together CityKids' young people with inaugural PSP Members representing Citigroup, Credit Suisse First Boston, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Lehman Brothers, Merrill Lynch, Morgan Stanley, and others. As CityKids President, Elizabeth Sak, remarked to the gathered crowd, "Private Sector Partners is creating unprecedented partnerships between CityKids and resource-rich financial services institutions, yielding cross-sector partnerships that benefit all involved."

Capacity Building: Strengthening Organizations and Training Individuals

As financial services institutions come to appreciate the organizational needs of nonprofit organizations, as well as the personal needs of their customer base, the building of infrastructure and skill sets is moving to the fore of community engagement efforts. The parallel is clear. Just as financial services institutions invest in the leadership and skills of their for-profit ventures, so too are they beginning to grasp the value of investing in the capacity of community organizations and customers.

The capacity building approach leverages the industry's comparative advantage as investors with financial and managerial expertise. For years, financial services institutions have nurtured the ability of private sector companies to operate efficiently and produce results, by applying their financial and human capital in strategic ways. Today, the industry is awakening to its parallel potential to do the same for the social sector and their customers. This shift represents a critical evolution from traditional donor to engaged investor. Natalie Abatemarco, Director of Global Community Programs at Citigroup, echoes this evolution, explaining, "We are looking to make an impact for generations to come, so we think it makes good sense to teach our partners and customers how to fish."

M&T Bank has partnered with the Fifth Avenue Committee, a nonprofit organization that works to foster economic and social justice in disadvantaged Brooklyn neighborhoods, to create a venture philanthropy account and leverage its assets to fund a community entrepreneurial program. Steven Flax, Vice President of Community Development, reflects, "We believe that funding and teaching entrepreneurial methods is simply an extension of our own business model, of what we talk about inside of the bank, so why not move it beyond our company boundaries? In terms of impact potential, these ripples in the pond extend outward for generations, as community residents gain the skills to start their own businesses and run their existing organizations more effectively."

Citigroup has pledged 200 million dollars over the course of 10 years to support global financial education. Among the beneficiaries of the initiative is Aspira, one of the largest Latino advocacy organizations in the U.S. Aspira, whose mission is to support the educational and leadership development of Hispanic youth, will use the money to support financial literacy programs for both youth and their parents. Natalie Abatemarco, Director of Global Community Programs, notes, "Citigroup is looking to develop healthy communities. By making capacity building investments within the financial literacy arena, we can dig deep and support longer philanthropic time horizons, and thus Citigroup can nurture communities throughout multiple lifecycles as their respective organizations mature over time. We are going beyond traditional philanthropy."

In 2005, **Wachovia** is significantly expanding its commitment to supporting the financial literacy of its customers and its communities. The firm's method is to partner with leading community groups to teach practical skills to individuals who need them most. Through its "Money Smart" and "eCommunitiesFirst" training programs, Wachovia has invested philanthropic dollars in developing educational tools and programs for financial literacy classes so that lower-income consumers can more readily access financial services, including the teaching of computer skills that enable people to manage their finances online and educating individuals with credit issues on how they can resolve them. Madelyn Ringgold, Managing Director of Philanthropic Advisory Services, explains, "We are seeking to infuse our philanthropy with practical skill-building, by sharing what our employees know and what we do best as a financial services firm. For us, it feels like a logical evolution in Wachovia's community engagement work.

Merrill Lynch is investing time and resources to ensure that under-served young people have an equal opportunity to be among the next generation of entrepreneurs and business leaders. The creation of a financial literacy curriculum and a mentorship program are among the initiatives that Merrill Lynch created to accomplish this mission. Westina Matthews Shatteen, First

Vice President, Community Leadership, Global Human Resources, notes that the Investing Pays Off program, "is consistent with who we are and what we can do as a financial services institution." Investing Pays Off has touched thousands of kids – from pre-school through high school. The IPO curriculum, which can be downloaded for free from Merrill Lynch's website, is used all over the United States and in 10 countries around the world. Merrill Lynch employee volunteers have introduced IPO strategies to classrooms, community centers and libraries in their communities.

Community Development: Bricks, Mortar, and Beyond

Building upon the movement that began in the 1960s with the emergence of community development corporations and the legislative momentum caused by the passage of the federal Community Reinvestment Act (CRA) in the 1970s, financial services institutions are devoting increasingly large sums of resources toward the development of affordable housing and minority-owned small businesses. As with the industry's financial literacy efforts, this engagement vehicle leverages existing institutional expertise (in real estate and finance) for mutual benefit. Peter Roulhac, Vice President & Director of Community Programs at Wachovia, remarks, "We understand that decent housing and successful small businesses are the foundation of healthy communities. As a company that possesses the money and know-how in finance and real estate, we are in a strong position to help communities build this foundation. From our perspective, they are us and we are them; so what do we have to lose? It's our privilege and our obligation, yes, but it's also our opportunity."

The **Independence Community Bank Foundation** has made strides in urban renewal. By working with various housing development organizations, including the Settlement Housing Fund and the New York Chapter of Habitat for Humanity, the Independence Foundation has been able to assist in the economic and social transformation of under-invested communities, especially in Brooklyn, where 55% of its philanthropic funds are distributed. Ben Esner, Deputy Director of the Foundation, cites the investment and eventual redevelopment of Crown Heights as an example of how strategic investment in underserved communities can spur neighborhood transformation.

In New York City, **Washington Mutual** has partnered with local community development corporations to support the development of affordable housing and to enhance community residents' knowledge of their housing rights and opportunities. In partnership with the Abyssinian Development Corporation, Harlem's leading CDC, Washington Mutual participates in the Harlem Economic Literacy Program to provide homeownership counseling and favorable end-loan products for ADC's affordable housing clients. As the firm does in partnership with CDCs across the U.S. in an effort to combat predatory lending practices, Washington Mutual's Community-Based Home Loan Center provides free personalized credit evaluation and loan shopping services.

Steven Flax, Vice President of Community Development at **M&T Bank**, realizes that M&T, "cannot be all things to all people." By focusing on community development, however, he believes that M&T can make a substantial impact. This focused approach has made M&T a leader in the community development movement, pledging 10 million dollars to the Neighborhood Opportunities Fund (NOF) over the next four years. In this capacity, M&T has been instrumental in expanding the low- and moderate-income housing market and simultaneously affecting public policy within the housing arena.

"We recognize our unique position to bring strength and capacity to our communities," says Peter Roulhac, Vice President & Director of Community Programs at **Wachovia**. To supplement its favorable-rate small business loans and mortgage lending designed for individuals eligible for Section 8 vouchers, the company partners with nonprofit organizations to provide free homeownership counseling to potential borrowers. In 2004, Wachovia lent 350 million dollars to construct affordable multi-family housing units and the firm's Tax Credit Investment Group provided equity investments to subsidize 6,000 units of affordable rental housing. In the years ahead, Wachovia will seek to partner with a larger number of local community development corporations to support affordable housing and small businesses that are, "consistent with community priorities."

Deutsche Bank works in partnership with local nonprofit organizations to provide distressed communities and disadvantaged individuals with opportunities for safe and affordable housing and economic advancement. “The Bank relies on the talents of its employees and the leadership of its management to leverage its financial commitments in addressing local needs, nowhere more so than in the arena of community development, where our resources can make a visible, lasting impact,” says Alessandra DiGiusto, Chief Administrator of the Deutsche Bank Americas Foundation. Grants from the Foundation support neighborhood-based organizations that develop affordable housing, housing for the formerly homeless or those at risk of homelessness, support the creation of new businesses, and generate employment opportunities.

Garry Nieuwenhuis, Senior Vice President of **Valley National Bank**, believes the Bank has an obligation to develop affordable housing in the communities where it does business. To help make this commitment real, Valley National maintains a long-standing relationship with Habitat for Humanity, a leading builder of affordable housing for low-income communities. The Bank provides an array of support services for the housing collaborative, including annual monetary contributions, volunteers, and management of the organization as members on the board of directors.

Policy

In addition to the Pareto Improvement opportunities and the mutually beneficial outcomes of community engagement activities, federal policy and programs provide even more incentive for financial institutions to become involved. The Community Reinvestment Act (CRA), the New Market Tax Credits (NMTC), and other policies are intended to increase investment in community development entities and activities in the form of tax credits and other financial incentives.

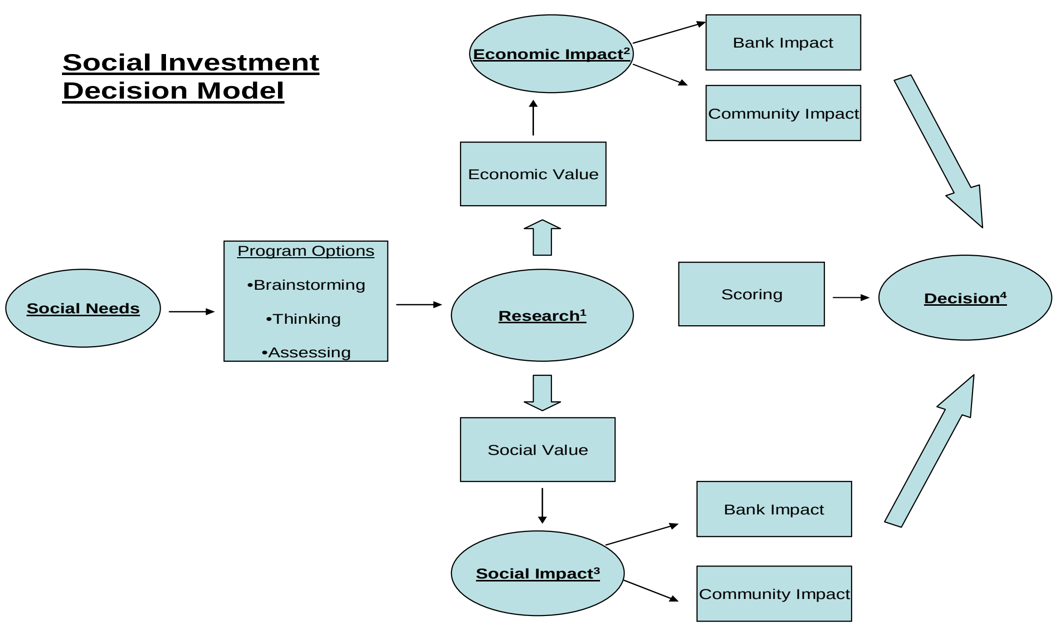
The Community Reinvestment Act (CRA) is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate including low- and moderate-income neighborhoods, consistent with safe and sound banking operations. Since the revision of the CRA regulations in 1995, financial institutions have stated that they find the community development investment test particularly challenging. The community development investment test is a means for institutions to assess the profitability and feasibility of an investment opportunity in their local communities. Yet, the factors that lead into this test can often be hard to identify and measure, as they are often social and qualitative in nature or can

Social Return on Investment

In the philanthropic community, the importance of measuring results has become central. In particular industries, results can be measured in terms of the priorities of a particular institution and the priorities of communities and society. Those programs that show strong results on both ends are ideal.

Social return on investment is a term now used by foundations, private investors and philanthropists, government agencies, academics, private social service agencies and other nonprofits working to help their communities. Building upon the logic of cost-benefit analysis, SROI translates community or social results into dollar impacts. This dollar amount is generated through both quantitative and qualitative measures.

As a result of Marga Incorporated's research, we developed a method through which financial institutions can determine potential investment paths in the social arena, our Social Investment Decision Model. This Model was created so that financial institutions could evaluate the value of each of those factors that ultimately determine the economic and social impact of a program. It is a tool which can be used as a rationale for supporting program decisions or a means of determining where next to invest.



The following points further explain some of the specific aspects of the Model:

1. Research consists of a combination of qualitative methods (e.g. interviews, focus groups, etc.) and quantitative methods (e.g. surveys, financial reports, etc.).
2. Areas of Bank Impact include improved increase in local consumer base, employee performance, and employee engagement.
3. Areas of Social Impact include increases in property values, reductions in crime rates, and improved household financial outlook.
4. Decisions are based on the highest score out of a possible 100 points. For example, prioritize the top three possible programs: Program 1 Score = 88, Program 2 Score = 82, and Program 3 Score = 74. Program selection is based on this scoring priority.

Social Investment Decision Model Walkthrough

Phase 1: Needs and Options

All institutions engaging in community relations and philanthropy are faced with making decisions about where to invest. Like any other area, philanthropic decisions require prior investigation and thought in order to reach conclusions. When financial institutions are determining social areas in which to invest, they are faced with a number of potential social needs.

Approaches to addressing any range of social issues, from affordable housing to financial literacy to economic development, vary widely. Some institutions would prefer to spread resources to as wide a variety of organizations and initiatives as possible. Others seek approaches that focus on a particular area, and develop a strategy around achieving results in that specific arena.

In the Social Investment Decision Model, we emphasize the significance of early brainstorming, internally and externally about where to invest. These early discussions, we think, should highlight a combination of factors that simultaneously incorporate the interests of the financial institution and importance of particular social issues.

This initial phase is about weighing program options. Options are influenced by a variety of factors including where the institution does business, the history of the institution's work in various areas, and the social significance of particular issues. Overall, early brainstorming and assessment are designed to identify where bank and community interests converge.

This early phase could be a facilitated process that reviews the accomplishments and challenges of past efforts, solicits preliminary feedback from stakeholders, and reviews existing data. The outcome of this phase would be a list of three or fewer program options.

Phase 2: Measuring SROI

The second phase is designed to ground the program options in research and data to determine what direction makes sense for both the financial institution and the intended community that would be served by the resulting program. Any institution has its own goals and core mission. Predicting the degree to which program options are in sync with an institution's mission and goals is essential in this respect. At Marga, we believe that institutions are more invested in the results of their philanthropic initiatives, and their overall relationship to communities when they can see how their efforts serve their mission.

Concurrently, it is critical that financial institutions engage in initiatives that demonstrate results in communities. Therefore, this second phase of the Social Investment Decision Model is designed to employ both quantitative and qualitative research methods in determining the potential impact of program options to both the financial institution and the intended community.

Financial institutions, in pursuing quantitative methods, could utilize different approaches to measure social return on investment. What is economically feasible for the institution to pursue? What will bring numerical results for communities? An example of quantitative approaches to measuring social return on investment is found in the appendix of this report.

Qualitative methods provide a range of opportunities to determine a more holistic picture of the value of a program option. Interviews and focus groups with employees and community residents and organizations could give an institution a deeper sense of how a program option might have an impact. Concepts such as inspiration and hope, for example, are rather difficult to determine through numbers. Qualitative research can round out this picture.

At Marga, we strongly encourage that philanthropic and community initiatives of all types draw some influence from target communities. Qualitative approaches enable institutions to come to conclusions about program options in collaboration with communities, driven by feedback from those who would stand to gain from programs. Early buy in from communities about such programs could very well enhance the chances of impact.

Communities become vested when they have played some role in shaping programs, and institutions are invested when programs logically extend from their broader goals. As a result, this process is a means of determining mutual gain.

Phase 3: Assigning Value and Deciding

The final phase of this model assigns value to the results of research. A scoring system enables institutions to review scores for each of the program options. The idea is to choose the path that provides the combination of the highest potential social impact and bank impact. This would be the initiative that demonstrates the greatest potential mutual gain.

Overall, the three phases indicated provide a method of decision making that effectively takes account of potential value across the board. Many speak of win/win relationships. This method intends to predict the degree to which programs and initiatives sponsored by financial institutions can be truly mutually beneficial to themselves and communities. Marga Incorporated's role would be to walk an institution through this process – facilitate meetings and focus groups, conduct research, score the results, and provide guidance on future directions based on these findings.

Social and Economic Benefits of Investing

Considerable data illustrates that investments provide numerous benefits both to individual families and to the broader community. The economic benefits to both the financial institution and the community from these kinds of investments can include:

- An increase in the community's economic growth, including increased long-term tax base, local consumer purchasing power, household financial outlooks, and the generation of new jobs and improved work performance for employers;
- An increase in overall community investment as other investors overcome the aversion to "go it alone;"
- An increase in the number of affordable standard housing units for low- and moderate-income persons; and
- An increase in the number of federal, state, and local subsidies, both attracted and retained.

The social benefits can include:

- A reduction in the crime rate;
- An increase in exposure of the community to new markets and cultures;
- Improved educational performance and a reduction in high-school drop out rates;
- Improved community and family health; and
- Increased household stability.

Advanced econometric analysis done by The Urban Institute's Metropolitan Housing and Communities Policy Center shows that community development investments in affordable housing and commercial retail facilities have led to increases in property values. These increases have been as great as 69% higher than they would have been in the absence of the investment. In addition, the analysis revealed that affordable housing helps to increase and stabilize both household and local economies, while providing an immediate

Quantitative & Qualitative Returns

Both qualitative and quantitative assessments are required to determine the true return of any community development program. Models have been developed by a number of institutions to quantitatively capture the return. However, these figures cannot reflect the full picture on their own. Qualitative analyses are necessary to understand the social impact on communities. And, these impacts can have a great affect on the success of an investment. Below, we will cover the quantitative steps to calculate the social return on an investment as well as the qualitative methods to calculate impact & return.

Quantitative Stages to Calculate SROI

From our perspective, measuring SROI takes on quantitative and quantitative qualities. Our Model is intended to assist financial institutions in determining, prior to investing, the most logical paths to take. One aspect of measurement focuses on dollars:

Stage 1: Calculate Program Cost

- Calculating costs per participant for the program and for government before the economic and social value added

Stage 2: Calculate Social and Economic Value

- Identifying socio-economic factors: direct, demonstrable cost savings and revenue contributions that are associated with participants, government and stakeholders in a social purpose program.

Stage 3: Calculate Social Saving

- Calculating the participant and government social and economic value, we calculate social savings. Our "return" is articulated in the Index of Return. This index tells us whether the investment lost, maintained, or created value.

Qualitative Assessment

However, with a solely quantitative approach, only one part of the story is told. A high index, from a strictly monetary perspective demonstrates economic value. However, a low or negative index of return doesn't necessarily equate to a poor investment. For some of the most disadvantaged populations, such as homeless people or individuals with mental disabilities, an increase in use of public services, at least for some period of time, may be desirable, resulting in lower public cost savings.

Subsequently, our Model recommends qualitative methods to measure value as much as quantitative ones. Interviews, focus groups, participant observations, case studies, and various types of qualitative research help determine a more comprehensive SROI. Placing numerical value on the results of both quantitative and qualitative assessments allows the model to result in a score for a particular initiative.

Qualitative Assessment: Pre-Investment

As in any quantitative assessment, the first step before making a community development assessment is to determine your baseline data. The following tasks will help a financial institution arrive at a point that will allow it to monitor the social impacts of the investment over time.

- *Task 1: Define the Purpose and Objectives of the Proposed Activity*. Summarize the general objectives and scope of the investment.
- *Task 2: Identify the Socio-Cultural, Institutional, Historical, and Political Context*. Determine the racial, ethnic, economic make-up of the population affected by the investment.
- *Task 3: Perform a Community Assessment*. Conduct focus groups with community leaders, business owners, and residents. Survey or interview the individuals and households included in your target population. The goal is to determine their needs and to incorporate this knowledge into decision-making processes. Identify any obstacles or barriers to entry.
- *Task 4: Generate Social Indicators for Ongoing Evaluation.* Answer the question: what social or qualitative indicators are appropriate to monitor for this investment? For example, indicators could include changes in attitudes, reputations, and/or behaviors.

Strategic Challenges and Opportunities

Financial services institutions are engaging with community and society in diverse ways. As these relatively new efforts mature over the coming years, the industry faces strategic challenges that can limit its social impact as well as strategic opportunities that can expand the mutual gain to unprecedented heights. As a result of our research and our experience with community and philanthropic initiatives, we have found that:

- *<u>Community partners should be viewed as social investments (not charitable recipients).</u>*

  The artificial distinction drawn between the private and social sectors can sometimes cloud decision-making and expectations. Just as financial services institutions maintain rigorous standards and high expectations for their private sector investments, so too should they bring sound strategic analysis to their community engagement investments. Just as financial services institutions invest in the capacity and leadership needs of the private sector, so too should they invest in the capacity and leadership needs of their community partners.

- *<u>The measurement of social return on investment (SROI) and mutual gain can enhance the value of financial institutions' sponsored social initiatives.</u>*

  In order to make the case for more strategic community engagement, financial services institutions must be able to measure SROI and mutual gain. Application of the proposed SROI measures and cost-benefit tools presented herein will more efficiently capture community engagement impact upon both societal well-being and institutional bottom lines. By more holistically framing the win-win Pareto Improvements, financial services institutions will be compelled to maximize their existing resources for societal gain – because this will be seen as the right *and* the profitable course of action.

- *<u>An understanding community priorities is critical to the success of social investments.</u>*

  When engaging communities, financial services institutions frequently operate from the tenuous position of instinctively reacting to social problems, rather than applying research-based knowledge that scientifically gauges and forecasts community priorities.

The traditional grantmaking/RFP process distorts community needs as it introduces the powerful temptation to 'chase the dollar,' to make needs fit funding guidelines. To overcome this distortion, financial services institutions can access research that includes the perspectives of community residents and leaders – and incorporate this community insight into their philanthropic processes.

- *Acknowledgement of required time horizons for complex social issues can enhance impact.*

All good things take time. So it is with positive change in under-resourced communities. In order to achieve maximum impact, community engagement efforts must be flexible in duration and consistent in purpose. Rigid grant cycles and ephemeral giving interests limit impact and stifle innovation, just as such capricious parameters would do to private sector investments. To do better, financial services institutions can become what a recent Funders Network For Smart Growth report terms "patient investors," who understand that SROI curves may require longer time horizons to show performance. By being "patient," financial services institutions can reap unprecedented mid- to long-term community engagement returns.

- *The application of better SROI measures and cost-benefit tools will lead to larger and more visible bottom line gains.*

Whether it's supporting the construction of affordable housing or the creation of small businesses, the application of better SROI measures and cost-benefit tools will lead to larger and more visible bottom line gains. Justified by these measures and tools, creative financing and partnership strategies can reconcile seemingly contrary internal agendas, allowing philanthropic divisions to be socially impactful and revenue-generating divisions to offer profitable services to under-resourced communities.

- *Financial services institutions can tap into their employees' latent impulse to 'give back.'*

As employee engagement becomes a staple of community partnerships, financial services institutions can tap into their employees' latent impulse to 'give back' for their own strategic benefit. By proactively reaching out to employees who have not yet identified specific community engagement pathways, financial services institutions can direct their employees to volunteer opportunities that fulfill their philanthropic visions. As organizations are but collections of individuals, bringing coherence to the individual will bring coherence to the organization.

- *The wealth of financial and human resources residing within financial services institutions has only begun to be tapped.*

By pooling this brainpower and institutionalizing skill sets in the form of a nonprofit training institute, or community leadership development center, this vast potential could be systematically harnessed. The employee engagement and financial literacy initiatives explored in the research represent a promising start. Institutionalized in a unifying educational structure – guided by technical assistance curricula that draw upon the diversity of employees' skill sets – communities could be transformed at relatively low cost.

- *Recognition for social programs can be achieved through value and impact.*

Traditionally, financial services institutions have gravitated toward community engagement efforts that are photo-friendly. However, as the public's attention span shrinks and digital technology democratizes media, the standard showcasing of good works becomes less compelling. As the public approach this saturation point and lose interest (in ubiquitous park clean-ups and walk-a-thons), the financial services institution that breaks the mold by investing in community capacity and leadership will naturally stand out and attract recognition.

Appendix

The following example is intended to present the social return on investment and the federal tax credit from engaging in community activities

Investor Profile

Bank A, one of the largest residential mortgage lenders in the country, has invested approximately $540 million in projects in Harlem over the past few years. This consists of more than 6,000 dwelling units and a half million square feet of commercial space. Approximately 40% of the company's mortgage lending business stems from underserved markets. Underserved borrowers include minorities across the economic spectrum, low- to moderate-income individuals, new immigrants, and borrowers in low income communities. This market segment historically includes African Americans, Asians, and Hispanics. In an attempt to increase its penetration in these lucrative markets, Bank A hopes to expand its share in underserved markets to over 50% of its total mortgage business.

To achieve this goal, Bank A Home Finance, the company's mortgage division, created MYHomeMaker, a 10-year, $400 billion commitment to providing increased home financing to underserved borrowers nationwide. While recognizing that minority and underserved markets offer the highest growth opportunities, Bank A is also dedicated to helping make homeownership accessible to all members of society.

Bank A has an opportunity to invest in a new housing project for low income residents in Harlem and needs to evaluate whether it is an attractive investment. This 48-unit housing project for single mothers and their children in West Harlem has an estimated total project cost of $3,986,902, which involves the acquisition of land and the construction of a new facility. As it is structured, the project can support rents starting at $492 a month for a studio, one-bedroom for $524, and $632 for a two-bedroom (not including heat and hot water), serving income levels as low as 50% of the Area Median Income for the region.

Quantitative Assumptions:

Tax Credit Analysis	
Low-Income Housing Tax Credit Analysis	
Total developing costs	$3,877,423
Land Cost	$200,000
Total Qualifying expenditures	$3,667,771
Eligible Basis	$3,667,771
Low-Income Proportion	100%
Qualifying Basis	$3,667,771
Equity required	$2,255,736
% of Investment	58%
Equity yield for Low-Income Credit	$0.75
Total Equity invested	$1,691,802
Federal Annual Credit %	9%
State Annual Credit	30%
Total Equity raised from Low-Income Credit	$659,803

Permanent funding for this project will be provided by tax credit equity in the amount of $2,255,736 and a soft loan of $725,000 from the Housing Trust Fund Corporation. Construction will be financed through a conventional construction loan, two grant donations for $966,802, and approximately a third of the tax credit equity. The information needed to calculate the Low Income Housing Tax Credit (LIHTC) amount comes directly from the project's development budget. Since this project is not receiving federal funding and it is new construction, it is eligible for the maximum 9% credit. For this type of project, the price of the credit dollar is currently around 75 cents, which is the price we used to calculate the Tax Credit Equity raised by the project.

From our analysis, we would recommend that Bank A invest in this project. Our calculations indicate that Bank A will receive a big return on investment from the tax credit equaling $659,083, which is 39% of the total investment.

Risks

As a result of the time and risk involved in investing in low-income housing, the discount rate associated with syndication has been fairly high, in this case 25%. The primary risks to the investor, Bank A, include the following:

1) Construction is not completed on time (at the end of the two year agreement) and the investors suffer a degree of early exposure through disbursement of some or all of their investment;

2) Difficulty finding qualified tenants (thus starting the flow of LIHTCs) as early as projected; and
3) The loss of tax credit and penalties if the community development entity fails to meet tax credit requirements

Why Should Bank A invest in the Single Mother's Low Income Housing Project?

- It qualifies for the 39% tax credit and projects internal rate of return of 6.6%.
- Bank A is experienced in investing in low income housing projects in the West Harlem area, has extensive knowledge about Harlem's community needs, and has this potential market to offer its products.
- Partners are knowledgeable about real estate.
- Syndicators have in depth knowledge and experience on their management teams and in the staff working on transactions. They also have solid underwriting processes and procedures that include checks and balances during the approval process.
- Syndicators have high quality tax counsel, underwriting, and asset management processes, as well as an impressive existing portfolio.

Social and Economic Valuation

Investing in this low income housing project for single mothers, Bank A not only obtained financial return, but also made a positive social and economic impact on the community. Valuating the social impact we found that even if the cost of capital was of 3%, the Single Mother's Project obtained a SROI of 106%. That is, for every $1 invested, $1.06 is created for society.

We considered that the mothers were likely living at shelters with their children at the time of the valuation. By the time the mothers and their children move to their new homes, it will decrease welfare expenses in the amount $2,251,970 annually. Many low-income workers, particularly single-women with children, must utilize federal housing subsidies to maintain shelter. Moreover, those who must depend on housing subsidies to maintain shelter are often marginalized and discriminated against.

Social and Economic Benefits

There are short and long term economic benefits for stakeholders and investors. This project required only short-term housing construction costs since it was a 2 year project, meaning that Bank A could claim its tax credit after 2 years of construction. In addition, this housing development now accommodates 48 families and motivated many single mothers to find employment, feeling their children had a safe place to stay. Since these women now have employment, welfare expenses decreased by over two million dollars annually.

Financial Institutions that find creative ways to support and increase economic activity in low-income and underserved neighborhoods demonstrate a long-term community commitment. Such investments can enhance a company's reputation and relationships with key stakeholders, including customers, employees, local communities and shareholders. For Bank A, this means an improved corporate image in the community, generating new clients and increasing public trust of the institution.