Driving Postsecondary Success with Impact Investing

Executive Briefing
Investment opportunities in the postsecondary access and success ecosystem

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Lumina FOUNDATION
THE KRESGE FOUNDATION
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Idea in Brief

SITUATION

Reaching Goal 2025—that 60% of Americans hold degrees, certificates or other high-quality postsecondary credentials by 2025—is essential to meeting our nation's growing need for talent. Assuming the current attainment level of approximately 45%[1] and current rates of degree and certificate production, 16.4 million more Americans need to earn postsecondary credentials to reach Goal 2025. Much of this population will have traditionally been under-represented in the educational system. A new type of student wrestling with rising education costs and emerging technologies is creating a revolution in postsecondary education.

ACTION

The Lumina and The Kresge Foundations are both committed to ensuring that America's talent needs are met and its new students included in the benefits of the nation's postsecondary education revolution. As part of their commitment, both are exploring tools beyond grantmaking to address the opportunities and challenges. Thus, in partnership, they commissioned Avivar Capital to conduct a landscape scan of the postsecondary education sector to identify capital barriers and gaps and to map opportunities to deploy multiple forms of capital, including MRIs and PRIs, to address the challenge.

RESULT

The Avivar Capital landscape scan found that continued innovation is needed to address persistent and emerging barriers to postsecondary access and attainment. Further, it found that there are capital gaps in advancing the postsecondary education revolution where foundations can play a catalytic role and where impact investing can help to advance promising solutions.

Why Education Impact Investing?

The U.S. is undergoing a tsunami of changing demographics alongside "rising inequality, persistent unemployment, failing schools, and broken cities."[2] By mid-century, the U.S. is anticipated to become a majority 'minority' nation and by the end of the decade, the majority of youth will be of color. However, "under-educated and under-prepared youth will not be able to support the nation's tax base"[3] or be prepared to assume the mantle of the 21st-Century workforce.

To address this challenge, America needs talent and the education system, from K12 to postsecondary, must change radically in order to provide it. There are large, powerful and influential forces at work to make this happen; from the White House to entrepreneurs to philanthropy. This is not only a national imperative, it is a human and moral imperative.

[1] *The Lumina Foundation, "A Stronger Nation 2016."*
[2] *Jamie Merisotis, "America Needs Talent: Attracting, Educating & Deploying the 21st - Century Workforce."*
[3] *USC, Program for Environmental and Regional Equity, "Talkin' 'Bout our Generations: Data, Deliberation, and Destiny in a Changing America." (2015).*

In assessing the landscape, we see opportunities for foundations to be catalytic by employing tools beyond grantmaking to drive capital, innovation and talent to the higher education sector. This is paramount as education impact investing only accounts for 2% of global impact investing assets under management according to GIIN and JP Morgan's 2015 Impact Investing Survey.

Education impact investing offers a number of benefits to investors and investees:

Figure 1: Education Impact Investing

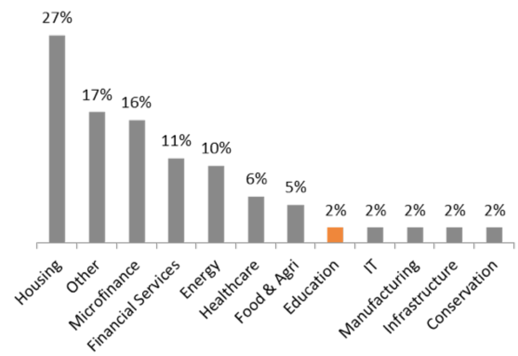


Table 1: Impact Investing (see glossary)

BENEFITS TO INVESTORS	BENEFITS TO INVESTEES
• Allows for deployment of greater amounts of capital, different types of capital and different types of engagement with both the investee and potential co-investors as well as other market actors. • Provides an equal seat at the table with a range of co-investors, helping to ensure focus on philanthropic goals and metrics. It can further help to evolve norms for how markets allocate capital, facilitating the flow of quality products and services as well as the democratization of information for those that need it most. • Enhances a foundation's long-term resources for philanthropy by recycling capital. • Can extend capital deployment beyond payout limits and allow the foundation to provide larger amounts of capital to a promising opportunity than might otherwise be possible with a grant. • The legal documentation of impact investments gives the foundation more control over investment outcomes through covenants and/or side letters that create opportunities for dialogue with investees when results vary from plan.	• Can expand and deepen impact while helping to create capacity/leverage, managerial discipline, financial sustainability and scale. • Since MRIs/PRIs are typically made in larger amounts than grants, they can help an organization achieve impact, sustainability and scale faster than might otherwise be possible. • This includes expediting proof of concept for innovative projects and allowing promising organizations to expand delivery of products and services more rapidly. • Can help to develop the organization's credit history and help management develop discipline through the process of having to qualify for, repay and regularly report on the investment.

> *"Strategic social investing is an opportunity for Lumina to exhibit leadership by catalyzing social investments targeted at increasing attainment and closing achievement gaps. We are eager to build this capacity and partner with other funders, investors and innovators."*
>
> Jamie Merisotis, Lumina Foundation President

Landscape Scan Process

Avivar conducted the landscape scan in an iterative process comprised of desk research, interviews, synthesis and analysis. Professionals from a wide range of backgrounds – Venture Capital, Private Equity, Incubators, Accelerators, Pay-for-Success and other foundations – were interviewed to evaluate the landscape. Insights from this process were distilled into a segmentation framework, a summary of forces shaping the sector, a summary of capital flows in the sector and sample investment opportunities. Subsequently, an investment strategy and criteria against which to measure potential investment opportunities was formulated in order to support the investment sourcing and diligence process.

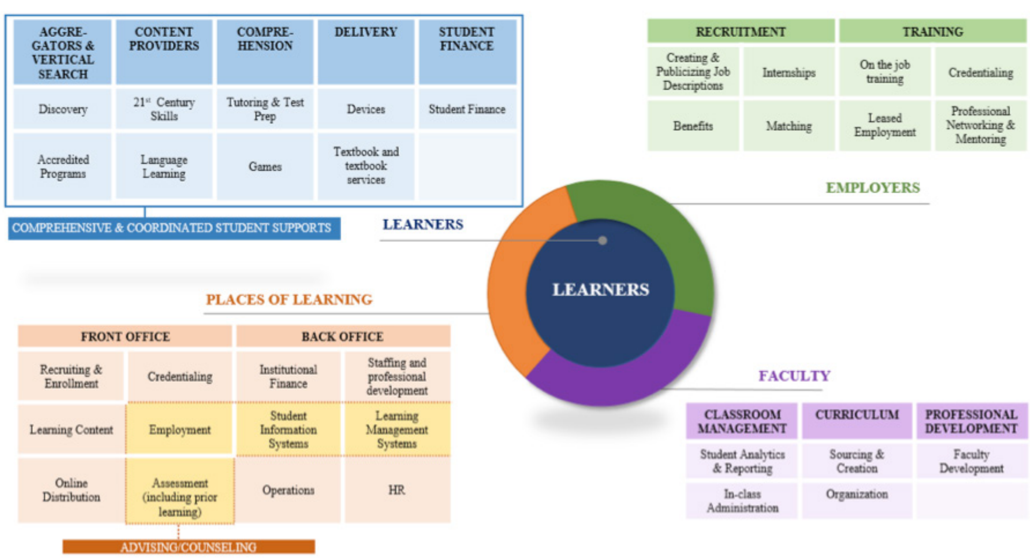
Segmentation Framework, Driving Forces & Capital Flows

A summary of the landscape scan and the areas it explores is outlined below:

SEGMENTATION FRAMEWORK

Avivar's segmentation framework is adapted from one 'open sourced' by Flybridge Capital Partners (FBC) in the spirit of 'hacking' education. The Avivar framework segments educational organizations by their primary beneficiaries or customers – learners, places of learning, faculty and employers. It further segments the landscape by the issue area that a product or service provider addresses and defines the type of solution that the organization provides. Additionally, consideration is given to comprehensive student supports – factors that indirectly affect learning e.g. food security – and the broader postsecondary education ecosystem e.g. Interdisciplinary Groups, Federal/State departments.

Figure 2: Postsecondary Education Segmentation Framework



This framework is not designed to neatly fit products or service providers into categories; rather it is intended to highlight key areas and/or business models that are shaping the educational landscape.

DRIVING FORCES

The following trends were identified as the driving forces behind the changing postsecondary education landscape and serve as context for finding potential impact investment opportunities.

- Costs are rising, affordability is decreasing, student loan debt is ballooning
- The face of today's postsecondary student is changing
- Enabling technologies are causing a shift in education delivery
- Rise of competency based education
- Community colleges are gaining relevance, though college isn't always the answer
- The labor market is shifting; the majority of current jobs will be automated away
- Increased federal appetite for innovation (though more uncertainty exists following the recent election)

CAPITAL FLOWS

Understanding the sources and uses of capital in the postsecondary education sector also provided valuable context for finding potential impact investment opportunities. The following trends in capital flows were identified.

- Less investment in education impact investing relative to other impact sectors
- Exponential growth in flow of capital into the edtech sector
- Rise of specialized edtech VC firms
- Early stage edtech ecosystem healthy; follow-on series A capital is declining
- Increasing number of edtech accelerators
- Employers spend a significant amount on formal and informal education & training
- Wealthier colleges raise significantly more in grants and donations than others

Strategic Implications

1. **America's need for talent coupled with the rising costs of education, changing demographics of students and enabling technologies are mobilizing a revolution in postsecondary education. Elements include:**

    a. Competency based content, degrees and credentials
    b. Formats that are responsive to the new student profile
    c. Unbundled services to optimize performance, portability and cost savings
    d. Rapidly evolving technology to support better educational outcomes and lower cost
    e. New institutional platforms for learning, including for-profit, decentralized and employer-based formats, along with new challenges for traditional institutions to keep pace with evolving student, employer and government demands
    f. Increased attention to supports that affect attainment (comprehensive student supports)

2. **There are capital gaps in advancing the education revolution, where foundations can play a catalytic role:**

    a. To build a track record and to attract additional capital for valuable educational innovation, edtech venture capital firms may target expected higher return/lower risk segments of the addressable market.

    b. This limits the flow of capital to deals targeting underserved populations, advancing the greatest innovation and/or carrying greater real or perceived risk.

    c. Foundations can play a catalytic role by ensuring the flow of capital to deals that increase equitable access to attainment and by providing "blended capital" (grants, patient and/or affordable equity and/or debt capital) to drive supportive innovation and deal development.

    d. Foundations can also join Series A, B and C capital rounds as needed to help promising early stage deals to prudently scale.

3. **Continued innovation is needed to address persistent and emerging barriers to access and attainment; impact investing can help to advance promising solutions:**

    a. Better information/counseling/mentoring on how to navigate the K12/postsecondary transition as well as the postsecondary/workforce transition.

    b. A broader spectrum of means to finance/pay for education.

    c. Financial literacy for students considering college debt and career income, beginning in K12.

    d. A more comprehensive and better coordinated array of comprehensive social supports for the new postsecondary student.

    e. Customized solutions to address the unique needs of students lacking legal status.

    f. Better preparedness for K12 students.

4. **As with any impact investing strategy, success requires managing a range of investment and program/mission risk. Investment worthy opportunities will:**

    a. Improve access, experience, outcomes and/or costs of higher education; they will add value versus duplicate, though the value may be via scaling tested models.

    b. Avoid unintended consequences, including increasing disparity and/or the flow of scarce subsidy to programs that are not attainment-driven.

    c. Advance charitable purpose in meaningful ways when structured as program-related investments.

    d. Promote leverage and co-investment by aligned investors, allowing more rapid achievement of Goal 2025 and related increased postsecondary access and success.

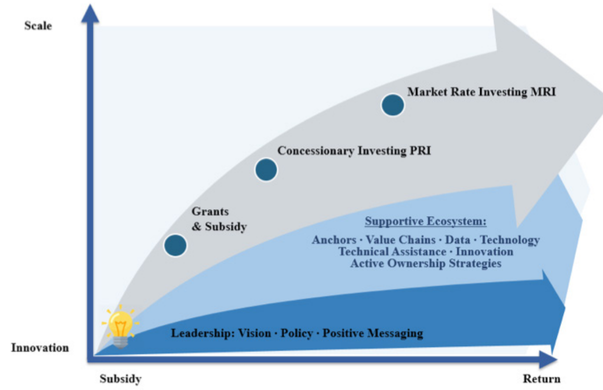
Investment Strategy

16.4 million more Americans need to obtain quality postsecondary qualifications over the next 8 years to meet goal 2025. In recognizing the scale and urgency of the issue, as well as the diversity of organizations in the postsecondary landscape, we see the opportunity to use the full spectrum of asset classes and impact investment types (MRI and PRI). These investments support scaling for-profit enterprises, nonprofit organizations, and interventions that have the potential to significantly contribute to Goal 2025.

The diagram to the right shows when and how various forms of capital can be used to advance promising interventions.

Note that impact investing is not always the best tool to achieve a mission. Careful consideration should be given to whether an investment or a grant is called for when evaluating an opportunity.

Figure 3: Benefit opportunities: PRI vs MRI vs Grant



Example Opportunity Areas

In order to harness the innovation of the edtech revolution to benefit America's new students, pioneering applications of existing capital structures and models are needed. Examples might include:

Edtech (Venture Capital)

Edtech has seen a significant increase in interest from investors recently as improved enabling infrastructure and new technologies – e.g. broadband, mobile devices, artificial intelligence and the advent of big data/predictive analytic tools – allow radically different business models and approaches to improving education outcomes. This growing interest is exemplified by the almost six-fold increase of venture financing into the sector between 2010 and 2015[4] and the establishment of several specialized edtech VC firms and start-up accelerators over the same period. We view this as an area of opportunity as technology enabled solutions can typically achieve scale quickly and help to reduce costs.

Scaling proven solutions in the non-profit arena (Debt)

As with non-profit organizations in other impact areas, capital constraints often affect the ability of non-profits in the college access and success arena to scale. According to New Profit, a venture philanthropy firm working in the space, the leading 15-25 high performing college access and success organizations serve approximately 7% of target low income students in aggregate. Better access to and use of debt capital could help qualifying non-profits to more effectively manage working capital and serve more students.

[4] *CB Insights*

Comprehensive Learner Supports via Community Development Financial Institutions (Debt/Novel Structured Products)

Up to three quarters of all college drop-out decisions among historically underrepresented students are non-academic in nature and may be linked to college attendance costs and family or work responsibilities.[5] Recognizing this, we feel that there is an opportunity to use debt or novel structured products to provide student supports. For example, character based lending may be one way to address the issue of emergency college costs for students. Nusenda's SEG Pledge Loan Program exemplifies this: Nusenda Credit Union's SEG Pledge Loan Program is a micro credit program that relies on community partners, including local universities, for business development, underwriting, and collateral. Nusenda identifies partners based on character, capacity, capital, collateral, and other conditions. The partner organization identifies and underwrites the end borrower while Nusenda issues the actual loan. Meanwhile, the partner organization deposits 100% of the value of the loan with Nusenda as cash collateral. Nusenda leverages the partner's deep rooted relationships to mitigate risks on these character loans.

Through the University of New Mexico (UNM) partnership (branded as "Powering Success"), student borrowers receive loan forgiveness. Upon successful completion of each semester, UNM will repay a portion of loan principal on behalf of the student. Upon graduation, the student's loan is fully repaid by UNM.

Conclusion

America's need for talent coupled with the rising costs of education, changing demographics of students and enabling technologies are mobilizing a revolution in postsecondary education. There are capital gaps in advancing the education revolution, where foundations can play a catalytic role. Continued innovation is needed to address persistent and emerging barriers to access and attainment; impact investing can help to advance promising solutions. As with any impact investing strategy, success requires managing a range of investment and program/mission risk.

[5] *Institute of Higher Education Policy, "Supporting Best Practices in Student Success: Lessons from the Field*

Glossary

Impact Investing: A Tool for Driving Social Outcomes

Impact Investing is the practice of investing into companies, organizations and funds with the intention to generate measurable social and environmental impact alongside a financial return (Global Impact Investing Network). Impact investments can be made across a range of risk-adjusted expected financial returns and in any asset class (investment structure, such as debt, equity, etc.).

- **Program-related investment (PRI)** is a regulatory term that refers to investments for which the primary purpose is charitable; no significant purpose is the generation of income or the appreciation of capital; and no purpose is lobbying. PRIs are typically investments in which to drive charitable purpose, the investor accepts a lower rate of expected financial return and/or a higher level of risk than would a conventional investor.
- **Mission-related investment (MRI)** is a term of art that refers to investments in which the investor seeks a social and/or environmental benefit alongside an expected market rate of risk-adjusted financial return.
- **CDFIs or Community Development Financial Institutions** are frequent partners financial intermediaries whose primary purpose is community development in underserved communities and/or to benefit underserved target populations.
- **Social Impact Bonds and/or Pay For Success** structures are novel impact investment structures in which impact investors front the capital to community organizations for the provision of services that can save government spending. If the community organizations can provide services in a way that saves government spending (the success in “pay for success”), then the investors are repaid, typically with some yield or return on their investment.

About the Organizations

ABOUT LUMINA FOUNDATION

The Lumina Foundation is an independent, private foundation committed to increasing the proportion of Americans with high-quality degrees, certificates and other credentials to 60 percent by 2025. Lumina's outcomes-based approach focuses on helping to design and build an equitable, accessible, responsive and accountable higher education system while fostering a national sense of urgency for action to achieve Goal 2025. To learn more, visit **luminafoundation.org**.

ABOUT THE KRESGE FOUNDATION EDUCATION PROGRAM

The Kresge Foundation is a private, national foundation that works to expand opportunities in America's cities through grantmaking and investing in arts and culture, education, environment, health, human services and community development in Detroit. It promotes student-centered postsecondary access and success in cities, supporting efforts to help low income, first-generation and underrepresented students earn credentials that open doors to opportunity and the economic mainstream. To learn more, visit **kresge.org/programs/education**.

ABOUT AVIVAR CAPITAL

Avivar Capital is a U.S based SEC registered investment advisory firm focused on managing impact investment portfolios and developing impact driven funds on behalf of our clients. The firm serves as an impact investment advisor, at times collaborating alongside traditional wealth advisors in crafting impact portfolios. The team has more than 90 years of collective financial management, impact investing and economic development experience working with successful entrepreneurs, foundations, banks, municipalities, and other institutional investors. To learn more, visit **avivarcapital.com**.