



## FREQUENTLY ASKED QUESTIONS ABOUT PROGRAM-RELATED INVESTMENTS

Adapted from *Answers to the 10 Most Asked Questions about PRIs*, Office of Program-Related Investments, Ford Foundation.

### **What is a Program-Related Investment?**

A program-related investment (PRI) is a type of mission or social investment that foundations make in order to achieve their philanthropic goals. Like grants, PRIs are vehicles for making inexpensive capital available to organizations that are addressing social or environmental concerns. Unlike grants, PRIs are expected to be repaid, often with at least a modest rate of return. Once repaid, PRIs are reused for other charitable purposes.

PRIs are generally made in the form of deposits, loans or equity investments. PRIs may involve diverse financing methods, such as subordinated loans, revolving funds, loan guarantees and linked deposits.

PRIs emerged as a formal philanthropic activity in response to the Tax Reform Act of 1969. The law cautioned private foundations against making any investment that could imperil its ability to generate funds needed to support its charitable activities. However, under Section 4944, private foundations are allowed to make “program-related investments” that may generate limited or no financial return, provided they met three criteria:

1. The investment’s primary purpose must be to advance the foundation’s charitable objectives;
2. Neither the production of income nor appreciation of property can be a significant purpose; and
3. The funds cannot be used directly or indirectly to lobby or for political purposes.

Provided these terms are met, the IRS does not consider PRIs to be jeopardizing investments, and private foundations are allowed to include PRIs as part of their annual required payout.

### **Why Make PRIs?**

Foundations and other donors make PRIs in order to stretch their financial resources and enhance their philanthropic impact. PRIs are often part of a larger philanthropic strategy that may include grants, PRIs and market-rate mission-related investments (MRI).

PRIs are often made by foundations in order to:

- Attract public and private contributions and leverage commercial financing for high value projects and initiatives.
- Strengthen the capacity of recipient organizations by improving cash flow, increasing access to capital, building financial capacity, and fostering long-term sustainability.
- Enable foundations to manage and increase their distributions through economic cycles.

### **Who Makes PRIs?**

Foundations of all types and sizes—including family, community, corporate and private foundations—make PRIs. In addition, non-foundation charities associated with corporations, religious organizations, donor-advised funds and investment circles make social investments that are similar to PRIs. Increasingly, foundations and other funders have collaborated to finance special

purpose organizations or other financial intermediaries which, in turn, lend money to qualifying organizations.

### **How are PRIs Used?**

PRIs are used for all kinds of charitable purposes, including affordable housing, arts, community development, cultural organizations, historic preservation, economic development including entrepreneurship and micro-businesses, charter schools, health clinics, childcare centers, faith-based structures and programs, social services, sustainable agriculture, fisheries and forestry, and wildlife habitat protection. They are used to fund capital projects, bridge loans and loan funds; to support microfinance institutions and promote economic development through loans to small and medium-sized businesses; to help organizations acquire property; to create jobs; and to develop new products or expand services.

### **What is the Right Size and Duration for a PRI?**

PRIs range in size from as little as \$1,000 to several million dollars. Generally, the amount of the PRI depends on the need and capacity of the recipient as well as the scope and size of the foundation, and its tolerance for risk.

The duration of the PRI may be from a few weeks to five or even ten years. For example, a foundation may establish a revolving fund to provide short-term bridge payments that are required to be repaid within a few weeks. Conversely, PRIs may be used to support a multi-year community development project or fund a new business that requires long-term, patient capital.

### **What is the Expected Return on a PRI?**

To qualify as a PRI, the IRS requires rates to be below market on a risk adjusted basis, but the actual rate of return or earnings on PRIs can vary. While PRIs are often made with the expectation of a rate of return between 0 and 3 percent, the rate may be higher depending on the level of risk involved. The rate is generally based on the borrower's ability to make principal and interest payments over a specified period of time. A foundation's desire to generate income from its PRIs may also affect rates, provided that earnings are not a significant reason for making the PRI.

### **How often are PRIs Repaid?**

Most PRIs are repaid on time with interest. Repayment rates may vary depending on the type and level of risk foundations choose to take in making their PRIs. For that reason, some foundations establish a loan loss reserve of as much as 15 percent of their PRI portfolio and/or mitigate risk by making loans through intermediary organizations such as community development financial institutions (CDFIs). In addition, risks can be eliminated by limiting PRIs to deposits in FDIC insured banks and credit unions.

### **How do Foundations Fund PRIs?**

A foundation may set aside a portion of its endowment assets to fund PRIs, or incorporate them into its grant or program budget. In either case, PRI disbursements count toward the foundation's annual required distribution.

### **How do Foundations Account for PRIs?**

Private foundations claim PRIs on their Form 990s to mark the transactions as charitable activities. This allows PRIs to be counted as part of a foundation's minimum payout in the year of distribution. Outstanding PRIs remain on a foundation's balance sheet as a separate asset category until they are repaid or written off. Periodically, adjustments may be made to the carrying value of PRIs depending on the likelihood of collection. Return of PRI principal is equivalent to a refund of a grant and, thus, increases the annual payout requirement by the amount of principal repayment. Interest income or earnings from PRIs are treated the same way as earnings from any other foundation investment.

Other entities, including community foundations, social investors and corporate giving funds may use the term "PRI" to refer to a concessionary investment for a charitable purpose, but there is no legal requirement for them to use the term "PRI."

### **What Special Expertise is Needed to Make PRIs?**

PRIs can range from simple cash deposits in community banks or credit unions to complex financial transactions. Foundations generally focus on making the kinds of PRIs that are most aligned with their mission and goals, their internal expertise and capacity, and their tolerance for risk. In undertaking PRIs, foundations should consider the following:

*Skills*—Structuring and monitoring PRIs require financial as well as program skills. However, board members, consultants and the foundation's financial management staff can often provide the necessary expertise.

*Staff Time*—PRIs may require more staff time per project—though not per dollar—than grantmaking. Attention to monitoring outstanding PRIs varies with a foundation's threshold for risk.

*Legal Counsel*—Because they often involve loan documents and/or other financial agreements, PRIs typically require more legal expertise than grants.

### **For more information, please contact:**

Peter Berliner  
Managing Director  
PRI Makers Network  
pberliner@primakers.net  
206-443-8462  
www.primakers.net