

Giving...and Receiving

With program-related investing, charitable foundations expect to get their money back—and then some

By Rachel Emma Silverman

CHARITABLE FOUNDATIONS typically give away money to fulfill their philanthropic missions. But increasingly, they expect their money back—with interest.

It's called program-related investing, or PRI. The idea is to make investments—usually loans at below-market rates or equity investments—that further the foundation's charitable goals. PRIs can help foster a greater sense of responsibility among the beneficiaries, and, since the investments may provide a return, boost a foundation's impact as the money gets recycled into other projects.

PRIs are used for a wide variety of charitable purposes. Like small-business loans, they help fund projects such as affordable-housing construction, child-care centers, health clinics and other community redevelopment programs. They can also be used, say, to help buy property for environmental or historic conservation. Foundations with an international scope often use PRIs to help make microfinance loans, or tiny loans to poor entrepreneurs in developing countries.

Most PRIs are low-interest loans, but they can also take other forms, such as equity investments or loan guarantees.

Investing in impoverished communities—which traditionally don't have access to conventional sources of capital—can help move them into the economic mainstream, says Debra Schwartz, director of program-related investments at the John D. and Catherine T. MacArthur Foundation in Chicago. The foundation has been doing PRIs for 25 years and is committing some \$45 million this year to new investments, primarily in affordable housing and economic development.

Multiple Benefits

There are lots of financial benefits

for using PRIs. For one, they help meet certain tax-code rules. The Internal Revenue Service requires private foundations to distribute at least 5% of their investment assets every year for charitable purposes. Normally, the foundations make grants to meet this requirement, but tax laws also count PRIs toward the 5% payout.

Other benefits include the ability to recycle returns on the loan or investment into other philanthropic projects. PRIs are sometimes larger than grants, too, since the principal is likely to be returned.

There can be philosophical motives as well: Some foundations feel that making loans or expecting investment returns encourages a greater degree of accountability than simply making a grant.

In order to qualify as a PRI under IRS guidelines, the investment's chief purpose must be charitable, rather than a hefty return. That's why most PRIs feature below-market rates or have generous terms. Nor can PRIs be used to influence legislation or advance a political campaign.

"What is important is that the intent of the investment is to further [the] mission," says Shari Berenbach, executive director of the Calvert Foundation, Bethesda, Md., which offers investment products that other charities can use to make PRIs, such as low-interest loans to recipients selected by the foundation.

"If [the mission] is to alleviate poverty, you have to see how the investment is oriented to alleviating poverty," Ms. Berenbach says.

For the recipients, meanwhile, there are benefits apart from the capital received, including the opportunity to demonstrate their creditworthiness and fiscal responsibility. A loan from a foundation can serve as a key steppingstone to obtaining more traditional forms of capital, such as bank loans or for-profit investors. "It's a magnet to attract others," says Mary

Anne Rodgers, counsel for the David and Lucile Packard Foundation, based in Los Altos, Calif.

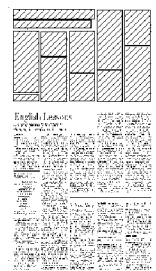
Choose Carefully

But PRIs aren't appropriate for every organization or project. It helps if the investment produces an income stream or acquires rights to assets that are expected to appreciate or can be liquidated. (Rental real-estate investments, for example, are attractive because rent provides a steady income flow.) Foundations also say they only invest in or lend to recipients that can handle the responsibility. Many foundations only make PRIs in nonprofits or projects that have received grants in the past and have strong performance records.

Although PRIs can be risky, foundations say loan defaults or equity investments gone bust are rare. Indeed, some 75% of foundations that have made loans in the past 40 years have had default rates of zero, according to a new study by ESG Social Impact Advisors, a nonprofit consulting firm based in Boston that examined investing programs at 92 U.S. foundations of all sizes.

PRIs aren't new, but they're growing more popular. The Ford Foundation, which pioneered PRIs, has been doing them since the late 1960s, and the investments have been sanctioned in the federal tax code since 1969. These days, the \$13 billion Ford Foundation has about \$280 million earmarked for PRI investments. One example: a 10-year, \$5 million investment in ShoreBank Enterprise Detroit, which provides loans and technical assistance to small and minority-owned businesses in that city.

Statistics on the scope of program-related investments are tough to come by, partly because PRIs are often mixed together with what are known as "mission-related investments." That's when foundations invest a portion of their assets in projects that have two goals, or a "double bottom



line”: furthering their charitable purposes and making money. Many mission-related investments seek market rates of return. By contrast, the chief aim of a PRI is to meet the foundation’s charitable purpose, rather than to make lots of money.

Rapid Growth

The **ESG** study found that mission-related investing and PRIs have grown substantially in recent years, with the “vast majority” of the activity concentrated in PRIs. New money committed to mission and program-related projects grew at a compound annual rate of more than 16% over the past five years, compared with less than 3% during the preceding 32 years, the study found.

The Packard Foundation exemplifies the growth. In 1980, it made its initial PRI investment with just \$6,000. By 2000, the foundation had nearly \$107 million in program-related investments. As of last August, that number had grown to \$156 million.

It’s not just big foundations that are making these investments. A growing number of small and midsize foundations are turning to PRIs. Michael Rauenhorst, for instance, a trustee of his family’s \$3 million foundation, makes PRIs in microfinance projects in Haiti, Jamaica and Bolivia. (Currently about \$500,000 of the foundation’s assets are in PRIs.)

The investments fit with the foundation’s philosophy of “helping people to help themselves,” says Mr. Rauen-

horst, a New York banker. With grants, he adds, it can be hard to know exactly how the money is eventually used. PRIs, however, tend to be tracked over a period of years to ensure the money is returned.

“There’s ultimately more accountability with a PRI,” he says.

Many smaller foundations choose to invest through intermediaries—providing capital to community banks, for example, which then make loans to end recipients.

The Calvert Foundation is one such intermediary. It offers “community investment notes,” which require a minimum \$1,000 investment and currently offer returns of up to 3%. The notes can be earmarked to invest in a variety of community-development projects in the U.S. and overseas. “They’re an easy PRI in a box,” says the foundation’s Ms. Berenbach.

For those interested in making PRIs, a good place to start is the Web site of the nonprofit PRI Makers Network, www.primakers.net, which provides lots of information about the investments and networking opportunities among foundations that make PRIs. Before making any investments, however, be sure to consult a lawyer and tax adviser to ensure the commitments stay within IRS guidelines. ■■

Ms. Silverman is a staff reporter for The Wall Street Journal in Austin, Texas. She can be reached at rachel.silverman@wsj.com.