Ford Foundation Program Staff

Program Related Investment and Recoverable Grant Primer

Program Related Investments – An Overview

The Ford Foundation originated the concept of program related investments (PRIs) for the philanthropic community in 1968 and has since provided PRIs to help finance revenue-generating, social-purpose projects of more than 325 organizations in the United States and around the world. PRIs have been used primarily to finance production of affordable housing for low-income people, small and medium enterprise development, social ventures, and facilities development for nonprofit organizations. At the close of FY 2003, net commitments for PRIs totaled $375 million.

Program staff use the PRI tool to support charitable activities that are likely to afford a return of capital to the Foundation. At Ford, they generally take the form of equity investments or loans of between $1 and $3 million that are made available over terms of 5 years or more at a one percent annual interest rate. PRI recipients (or investees) are both nonprofit organizations as well as for-profit organizations fulfilling charitable purposes that are otherwise unable to obtain capital from other sources. Projects supported by PRIs fall into one of two categories. They are either a charitable activity (a social enterprise or a facility) that is expected to generate revenue, which, in turn, can be used to repay the loan; or a charitable on-lending or investing vehicle, where the returns of principal and interest from the investments are expected to be sufficient to repay the loan.

Foundation investees benefit from PRIs in many ways. A successful PRI recipient may develop greater capacity to pursue its program goals, to negotiate with funding sources, and to make long-term strategic plans. Moreover, obtaining a PRI can help leverage other funding sources and managing a revenue-producing enterprise can foster the development of new management skills and disciplines. Over time, borrowers are likely to develop productive, long-term relationships with the Foundation and, if successful, to become more “bankable” organizations with sound credit histories.

PRIs also offer benefits to the Foundation. They provide an additional method for supporting program initiatives and enable the Foundation to meet an organization’s funding needs at a higher level than typical grant sizes would allow. In addition, PRIs, once repaid, permit recycling of the funds for new projects. They also leverage support for specific projects and, if successful, demonstrate to other potential lenders the value and effectiveness of social investing.

PRIs are funded through a set-aside from the Foundation’s corpus that is currently capped at $200 million, representing the total amount of PRIs that can be outstanding or committed at any moment. The Foundation’s current annual budget for PRIs is $17 million. The PRI Fund has been managed by the Asset Program’s Economic Development Unit since the

> This guide provides basic information about program related investments (PRIs) and recoverable grants -- program tools managed by the Asset Program’s Economic Development Unit that are available to all Foundation units and overseas offices. The aim is to help program officers, unit directors, and overseas representatives determine how these tools might help advance their program goals and how to go about developing and using them. EDU staff are available to give additional information to interested offices or units, either in person or through video conferences.
>
> *For further information contact EDU Director Frank DeGiovanni or any EDU staffer.*

Foundation's reorganization in 1996. Since 1997, about two-thirds of all PRIs have funded EDU grantees, while grantees of other units and of overseas offices have received one third of all PRIs.

In working with other units and overseas offices on PRIs, the Economic Development staff take responsibility for organizing due diligence on business and legal issues, coordinating PRI processing with internal legal and finance units at Ford, and (of course) providing capital from the PRI pool. Referring units and offices are responsible for assessing the programmatic "value" of the proposed PRI activities and maintaining an on-going grant relationship with the organization during the life of the PRI. In addition, because many prospective PRI recipients need financial strengthening, the referring office or unit often makes a companion "net asset" grant to build the financial strength of the grantee equal to ten percent of the PRI. Further, EDU staff may look to referring units for assistance with special issues – covering extraordinary legal fees, for example, or arranging for translation of documents. Overseas offices usually are asked to help monitor the borrower because staying in close touch with borrowers over long distances can be challenging.

Eligibility Criteria for PRIs

The federal Tax Act of 1969 defines PRIs as any investment by a foundation that meets three basic tests: (1) its primary purpose is to further some aspect of the foundation's charitable mission; (2) no significant purpose is to produce substantial income or property appreciation; and (3) no purpose is to support activities, such as lobbying or political campaign activities, which are prohibited under the private foundation rules. EDU staff have established four additional criteria for PRIs:

- <u>Program fit</u>: The activity to be undertaken must address the program goals and mission of the Foundation.
- <u>Existing relationship with the Foundation</u>: PRIs typically are made only to organizations that either are, or are in the process of becoming, grantees of the Foundation. This criterion reflects past experience that the most productive and successful PRIs are those where the Foundation also provides grant support and where a program officer is able to step in with supplemental support if the borrower begins to experience problems. A grant relationship with the Foundation is especially important when the prospective borrower works in a field with which EDU staff have little experience.
- <u>Financial Feasibility</u>: The project or activity to be financed by the PRI must have a reasonable likelihood of repayment that can be projected with defensible assumptions. One of the important factors in deciding whether to make a PRI involves weighing program benefit against financial risk, which typically is much greater than that taken by conventional lenders. Moreover, the Foundation's desire to leverage funds from other institutional investors means that PRIs may be subordinated to other investments, thereby increasing overall risk.
- <u>Need</u>: The prospective borrower must need our funds. That is, the project would not happen, or would occur at a reduced scale, in the absence of our resources. The prospective borrower cannot just be "shopping" for the lowest possible interest rate.

The PRI Process

The Foundation's PRI process comprises three stages. In the early stage, which takes one to three months, the Foundation undertakes a <u>preliminary review</u> to assess whether the proposed PRI meets threshold tests for program fit, charitability, financial need, and business feasibility. Working with referring program officers, EDU staff generally collect basic and readily available financial, organizational, and project information on the prospect investee and also work with the referring office to understand programmatic issues. A summary of findings from this preliminary analysis is presented for consideration to a committee of EDU and legal staff. Often the referring program office attends this meeting in person or by conference call.

Next, the Foundation undertakes a more formal due diligence phase to assess the request in detail. A formal proposal, business plan, and other supporting documents are required from the prospective borrower. After review of these materials, the assigned EDU program officer and the referring PO undertake a site visit to meet with key leadership, staff and constituents of the organization. Once a formal proposal is received, this phase takes between three and four months. Upon successful completion of the due diligence phase, an RGA will be prepared and submitted, including a description of the activities and the organizational profile, a term sheet, a financial pro forma, and a risk analysis.

Finally, the Foundation works with the borrower on a closing process that includes the development of a loan agreement, promissory note, and other supporting documentation necessary to make the loan. Once these have been finalized, the funds are transferred to the borrower. This process can take between two and four months.

Initiating a PRI Conversation

Program staff interested in exploring the possible use of a PRI should contact the EDU Director, Frank DeGiovanni, or any EDU program officer. Because of the long gestation and relative complexity of PRIs, it's generally best to begin this conversation quite early. The Economic Development Unit has also developed a Frequently Asked Questions briefing for prospective PRI recipients that can help grantees understand whether the PRI tool may be appropriate for their financing needs.

Recent PRIs

Social Venture A $2 million, seven-year PRI made in 2003 is supporting efforts to achieve financial self-sufficiency by openDemocracy Ltd., a United Kingdom-based Internet site that provides an independent forum for global debates on important contemporary issues. The PRI is providing the organization with long-term working capital while it expands and scales-up its efforts to sell individual, organizational, and academic subscriptions to its products. The borrower is a grantee of the Governance and Civil Society Unit and of the inter-program working group on religion, society, and culture. The PRI was preceded by a grant to enable openDemocracy to develop a business plan that tested its editorial offerings and the marketability of its products.

Facilities Development In 2002, long-term Human Rights Unit grantee Puerto Rican Legal Defense and Education Fund received a $1.5 million, 12-year PRI to finance the acquisition and renovation of office space adjacent to its New York City headquarters. A prior PRI, repaid in full in 1998, enabled the Fund to purchase its current office space, which became increasingly inadequate as the organization expanded to become a major national organization representing the Latino community.

Revolving Loan Fund The Kenya Women Finance Trust Limited, a long-term Foundation grantee of the Eastern Africa office providing low-income women entrepreneurs with direct access to the financial services and technical assistance they require to establish or expand small businesses, received a $2 million PRI in 1999 to help underwrite its microfinance program. In response to increasing demand for loans and in light of the Trust's attainment of operational self-sufficiency and its success in maintaining a loan repayment rate of 97%, the Foundation awarded the Trust a $1 million supplemental PRI in 2002. It increased the capitalization of the Trust's revolving loan fund to $7 million and is assisting the organization to implement a 10-year managed growth plan. Both PRIs were accompanied by grants to help capitalize the Trust's currency reserve fund.

Recoverable Grants

Like PRIs, recoverable grants are used to finance revenue-generating charitable projects, and they must meet the same programmatic and charitable criteria as those established for PRIs. Recoverable grants differ from PRIs in that they are used to finance higher risk charitable activities, where revenue generation and repayment are not as certain as that anticipated for PRIs. "Higher risk" generally means that the proposed project or activity is unproven or does not have a sufficient track record to assess risk. Recoverable grants also have been used to fund work in places with high currency risk or other macroeconomic or political risks. Key reasons for using a recoverable grant as a program tool are to test business feasibility, potentially attracting additional capital; and to develop market discipline within the grantee organization.

The Economic Development Unit's Recoverable Grant Annual Reserve of $1 million is available to all Foundation units and overseas offices. Recoverable grants range from $100,000 to $1,000,000, require no interest payments, and are usually repayable within 10 years or less. As with PRIs, the expectation is that referring offices or units plan to maintain an ongoing relationship with the proposed recoverable grant recipient. Recoverable grants typically are accompanied by a grant from the requesting program officer's portfolio, usually in an amount equivalent to one-third of the recoverable grant. Repayment terms are flexible. In general, repayment is triggered by revenue generation and/or successful refinancing arrangements with another lender. There is no repayment obligation if the project is unsuccessful in generating adequate revenue to repay the grant. Recoverable grants require a preliminary review, formal due diligence, preparation of financial projections and a term sheet similar to that used in PRIs. However, the closing process is streamlined because the legal documentation is far simpler than for a PRI.

Recent Recoverable Grants

<u>Enterprise and Facilities Development</u> In 2002 the Galilee Society: the Arab National Society for Health Research and Services, a grantee of the Human Rights Unit, was awarded a $1 million recoverable grant over 10 years. The Galilee Society has used this grant to add a new training structure to its Rural Development Center and to develop and expand educational programs and consulting services to local minority municipalities on sustainable methods of using reclaimed water. Revenues from fees charged for environmental consulting services and from Israeli government subsidies paid for each student participating in the Center's educational programs will be used to repay the grant. A RG rather than a PRI was made because of the high risk of economic and political adversities beyond the grantee's control.

<u>Enterprise Development</u> A $100,000 recoverable grant was made in 2003 to the Balete Ba Lekgophung Development Trust, an organization that has received significant technical assistance support under the Southern Africa office's grantmaking, to assist in the development of a community-based tourism project within the Madekwe Game Reserve in South Africa. Grant funds are helping to develop the luxury Ridge Safari Lodge in the preserve and to hire an operating company to run it, subject to social covenants relating to job creation and access and to financial returns to Lekgophung, a rural community of low-income people located at the edge of the preserve. Repayment of the grant is anticipated from cash flow received by the Trust from the operation of the lodge.