

PROGRAM RELATED INVESTMENTS: AN INTRODUCTORY GUIDE

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**GOODCOMPANY
VENTURES**



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“ Program Related Investments are used as high impact tools to stimulate private-sector driven innovation, encourage market-driven efficiencies and attract external capital to priority initiatives. ”

The Bill & Melinda Gates Foundation

“ As part of a broader strategy involving impact investing and the market-based solutions of target recipients, PRIs stand to tackle tough social issues on a scale never before seen by moving beyond traditional notions of charity that, in many ways, continue to restrain large-scale progress. ”

The Ashoka Organization

“ As a result of PRIs, ultimate beneficiaries have greater opportunities to improve their livelihoods and quality of life. ”

The Rockefeller Foundation

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DEFINITION: PROGRAM RELATED INVESTMENT

Program-related investments (PRIs) are an alternative way for foundations to fund social ventures while still fulfilling their charitable purposes. Specifically, PRIs are investments principally made for a charitable purpose, with the potential of a modest return. These investments can serve as qualifying distributions and count towards a foundation's annual 5% distribution.

QUALIFICATIONS OF A PRI

An investment must meet the following three criteria, established by the U.S. tax code, to qualify as a PRI:

- 1 Its primary purpose must be to accomplish one or more of the foundation's exempt purposes
- 2 It does not have the production of income or appreciation of property as a significant purpose
- 3 It is not intended to influence legislation or take part in political campaigns on behalf of candidates.

“The first thing we look at when making a PRI is mission alignment.” *Stephanie Rupp, Threshold Group*

Foundations have long recognized that grants have limited ability to solve social problems, so they have sought debt and equity investments in line with their missions to create greater impact. These investments are usually categorized as PRIs. Investments that qualify as PRIs can act as qualifying distributions — they can count towards a foundation's annual minimum distribution of 5% of the fair market value of its assets.

To qualify as a PRI, the primary purpose of an investment must be charitable. What does “charitable” mean in practice?

In determining whether an investment’s primary purpose is charitable, the IRS considers two factors:

- 1 Does the investment *significantly further* the accomplishment of the foundation’s specific exempt activities?
- 2 Would the investment have been made *but for* the foundation’s exempt purpose?

PREREQUISITES TO MAKING A PRI

Before making a PRI, a foundation must investigate the intended investee’s history, level of experience, management, activities, and practices to ensure the investment will meet the foundation’s intended purpose.

After the due diligence period, a foundation must design the specific terms of the investment, keeping in mind how the investment’s structure will meet the three criteria to be a PRI.

“ The diligence process for PRIs is not that different from the diligence process for other investments. ” Gabe Mandujano, Wash Cycle Laundry

MAKING A PRI

Are there limits on the entities that are eligible to receive PRIs?

There are no limits on the types of entities that may receive a PRI. The IRS has been clear: PRIs may be made in charitable or non-charitable, non-exempt entities. The only real limitation has to do with conflicts of interest. A foundation cannot make a PRI in an entity that would create a conflict of interest by unfairly benefitting a foundation's managers, major contributors or their families.

Are there limits regarding the form of investments a PRI can take?

The IRS is indifferent as to the form a PRI may take. A PRI can come in any form, including debt, equity, convertible notes, or even loan guarantees.

MONITORING AN INVESTMENT

Are foundations required to monitor their PRIs?

“ There’s a lot of ongoing diligence to make sure that the mission is being carried out. ” Teresa Wells, Threshold Group

The IRS requires foundations to monitor their PRIs. Therefore, foundations are responsible for the following:

- 1 Making all reasonable efforts and establishing sufficient procedures to ensure a PRI is spent solely for the purpose for which it is made
- 2 Obtaining full and complete reports regarding how its investment is spent
- 3 Submitting full and detailed reports to the IRS prior to making, at the time of making, and during term of a PRI.

	GRANT	PRI
Potential of generating return	X	✓
Eligibility for 5% qualifying distributions	✓	✓
Can the funds be used towards for profit targets?	X	✓
Do the funds provide an incentive structure to bolster likelihood of success?	X	✓
Availability of flexible terms to tailor to foundation's and recipient's needs?	X	✓
Provides flexibility for greatest social impact	X	✓
Reporting requirements	X	✓

HANDLING CAPITAL FROM A PRI

If the foundation receives a return of its original investment, it must redistribute that money for a charitable purpose within the next taxable year.

In contrast, any interest, income, or earnings from PRIs do not need to be reinvested. Instead, these funds will be treated as investment income, and subject to the 1% excise tax.

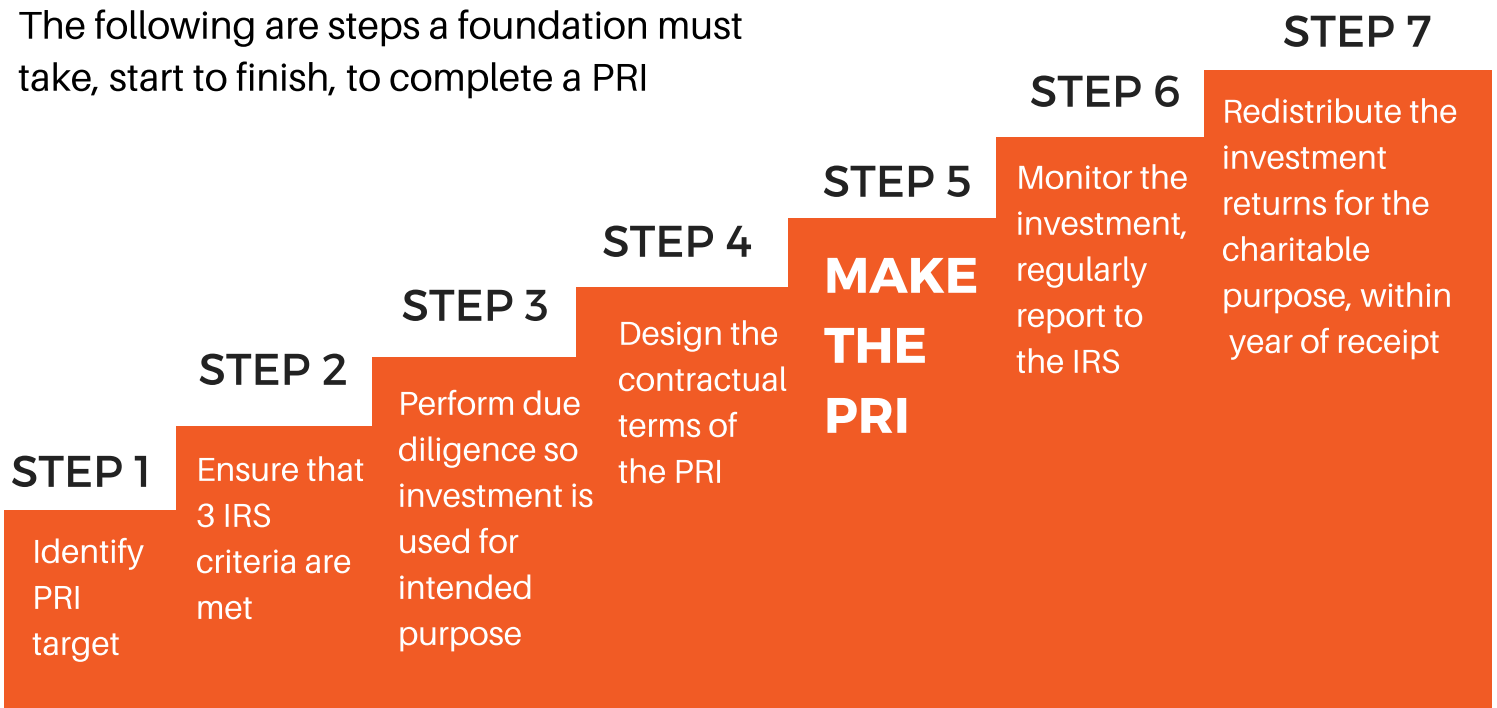
Of course, foundations should seek advice from their tax advisors in any circumstance.

“ PRI interest rates are somewhat of a red herring; we should focus on credit. ”

Gabe Mandujano, Wash Cycle Laundry

COMPLETING A PRI

The following are steps a foundation must take, start to finish, to complete a PRI



**Please note that this document does not
entail a comprehensive discussion of PRIs.**

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