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INVESTING FOR SOCIAL GAIN:

REFLECTIONS ON TWO DECADES OF PROGRAM-RELATED INVESTMENTS

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INVESTING FOR SOCIAL GAIN:
REFLECTIONS ON TWO DECADES OF PROGRAM-RELATED INVESTMENTS

Ford Foundation, New York, N.Y.

Library of Congress Cataloging-in-Publication Data

Investing for social gain: reflections on two decades of program-related investments.
p. cm. — (A Ford Foundation report)

Includes bibliographical references.

ISBN 0-916584-46-1

1. Ford Foundation. 2. Endowments—United States—Program-related investments. I. Ford Foundation. II. Series.

HV97.F62I54 1991

361.7'632'0973—dc20

91-29515

CIP

Photographs

Cover

Top, left, Marc PoKempner; center, Marc PoKempner; right, Chris Maynard

Bottom, left, Brunner Studios; center, Grameen Bank; right, Stephenie Hollyman

page vi, Stephenie Hollyman

page 2, Allen Morgan Photo Service

page 5, Culver Pictures

page 20, Chris Maynard

page 21, top, Stephenie Hollyman; bottom, Brunner Studios

page 32, Grameen Bank

page 33, top, Kathy Willens; bottom, LISC

page 44, Marc PoKempner

page 45, top, Stephenie Hollyman; bottom, Patricia Reynolds

Design, Marilyn Reichstein

Production, Sound Graphics

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PREFACE

Nearly twenty-five years ago the Ford Foundation began experimenting with a new philanthropic mechanism. Instead of making grants, which are drawn from the Foundation's earnings, the new approach involved setting aside a portion of the Foundation's capital assets to be used for loans, loan guarantees, or equity investments. Unlike grants, these Program-Related Investments, as they are called, are recoverable. Unlike other investments, they are earmarked for enterprises that advance social purposes and the Foundation's program interests.

PRIs provide funds for such projects as the rehabilitation of low-income housing, the revitalization of rundown neighborhoods, and the creation of jobs. PRIs incur a greater degree of risk and pay a smaller return than conventional investments. But they also help recipients attract other sources of public and private funds, develop financial experience, and produce income and accumulate assets to sustain their operations. Since 1968, the portion of the Foundation's corpus allocated by the Board of Trustees for PRIs has increased from \$10 million to \$130 million.

This booklet tells the story of the PRI experiment, how it evolved, and the lessons learned from it over more than two decades. Apart from its historical interest, this review may be useful to other funders thinking of adopting the PRI approach. The principal author is Jan Jaffe, former deputy director of the Office of Program-Related Investments and now director of planning and staff development for the Foundation. She was assisted by Thomas Miller, director of the Office of Program-Related Investments, and by Ellen Arrick and Melinda Marble, consultants to the Foundation.

Susan V. Berresford
Vice President, Program Division
Ford Foundation

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***An exhibition by Romare Bearden at
the Studio Museum in Harlem.***

INTRODUCTION

A Museum in Harlem

It is in Harlem on what used to be West 125th Street—renamed for Dr. Martin Luther King, Jr.—between Malcolm X and Adam Clayton Powell Boulevards. Outside, a bright magenta awning and a window display beckon passersby to a show of collages and paintings. A sign on the vacant lot next door announces a future sculpture garden. Inside, oak floors, pristine walls, and track lighting set off contemporary works by black and Hispanic artists.

The Studio Museum in Harlem, America's only accredited black fine arts museum, did not always own its present home. From 1967 to 1977 during its first decade of existence, the museum rented loft space at 2033 Fifth Avenue. Although it had earned growing recognition as a principal center for the study and display of black art in America, it lacked the space for permanent collections or archives.

When Mary Schmidt Campbell became director of the museum in 1977, one of her first priorities was to look for a new building—a key element in the quest to become an accredited fine arts museum. She asked the Ford Foundation for a grant to hire a consultant who could assess various potential sites.

After a long search, the Studio Museum found a building on West 125th Street. The five-story office structure, owned by a bank, had enough space for the museum and rental space for commercial tenants, and the bank was willing to donate the available space to a nonprofit organization.

The building had several disadvantages, however. It was in poor condition and required over \$1 million worth of renovations. In addition, squatters occupied the building, a liquor store with a ten-year lease was on the ground floor, and the adjacent vacant lot was a major eyesore.

“But the location was excellent, it had earned-income potential, and it was going to be *ours*,” says Campbell. The prospect of ownership kept the museum's staff and board going even when the project seemed unfeasible.

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The Studio Museum's new space has made possible events like this jazz concert.

“What seemed like a series of disasters became for me an intensive course in various aspects of nonprofit management,” says Campbell, who is now dean of the Tisch School of the Arts at New York University. “Federal regulations, tax law, budgeting, fund raising, construction, building management—I got a thorough grounding in all of them.”

Eventually, the museum was awarded an \$800,000 federal Urban Development Action Grant (UDAG) that would provide long-term financing for the necessary capital improvements. The museum developed a plan to raise the remaining \$250,000 needed for construction costs. But the capital campaign—the museum’s first ever—would take time to mount, and UDAG funds would be available only upon completion of the renovations. In the meantime, the Studio Museum had approached the Ford Foundation for a grant. When it became clear that interim financing was what was needed, the Foundation urged the museum to apply instead for a loan through its Office of Program-Related Investments.

At that time, Campbell was not familiar with the concept of program-related investments (PRIs). In the weeks that followed, she learned that they were investments made by a foundation—primarily in the form of loans, guarantees, or equity investments—to help support the same goals as its grant programs. PRIs were made from the Foundation’s corpus and served to extend and recycle funds available for charitable purposes.

The Foundation loaned \$1.05 million to the museum against the future revenue from the UDAG and the capital campaign. The City of New York guaranteed part of the PRI in case the capital campaign failed. The Foundation also granted the museum \$25,000 so it could hire a development director and a professional project manager to oversee the renovations.

The museum completed renovations and qualified for UDAG funds “in record time,” according to Campbell. The capital campaign was also a success and the Foundation was fully repaid. The museum even won a landmark tax decision case that gave the building tax-exempt status.

But, more important, obtaining the building had an effect on the Studio Museum that Campbell describes as “profound.” The new space attracted more visitors and the museum was able to offer major exhibits, jazz concerts, and other special events that drew large crowds. It also opened a museum shop. Several years later, the museum obtained accreditation and developed into a major national archive of black art. “We have moved from being a small center to a collecting museum with an archival function,” says Campbell.

The Studio Museum is one of the success stories in the Ford

Foundation's twenty-three-year experience with program-related investments. Not all PRIs made by the Foundation have been paid off so quickly, if at all, nor have all had as large an impact on the recipient organization. Still, in many ways, the loan to the Studio Museum illustrates the potential benefits of a program-related investment as a philanthropic tool:

- The PRI helped to build an asset of long-term usefulness to the museum that strengthened its capacity to pursue program goals.
- The revenue generated from leasing office space to commercial tenants provided a measure of financial independence for the museum that it had not had before.
- Obtaining debt financing placed the museum in active contact with new private and public funding sources.

These objectives could perhaps have also been achieved through a grant. But Foundation staff point out that the Studio Museum's request for a grant would probably have been turned down. A grant large enough to pay for the renovations would have been outside the Foundation's normal range—and would have been unnecessary given the availability of government funds.

Although the Foundation charged interest on the loan, it did not get the same dollar return it would have received from a market investment. But the high *social* returns on the project—the sense of pride in ownership, the museum's increased visibility, the development of skills for the people involved—justified the lower financial return.

Traditionally, foundations have pursued their philanthropic goals by either engaging directly in program activities or by making grants to enable other institutions to establish and operate programs. In 1968 the Ford Foundation added a third mechanism—the PRI—to its philanthropic tool kit. The PRI has become a valued addition to the practice of philanthropy by providing more resources and more flexibility to address Foundation goals. By making loans from the Foundation's corpus, a new philanthropic resource is created to stretch the assets available to support charitable activities, such as the Studio Museum's new facility. What follows is the story of that experiment and its evolution into a fully developed activity that is an integral part of the Foundation's charitable purposes.

A Trustee's Perspective

Donald S. Perkins, former chairman of Jewel Companies, Inc. and a Foundation trustee from 1977 to 1989, admits that when he joined the Ford Foundation board he had some misgivings about PRIs. "I

THE STUDIO MUSEUM IN HARLEM IS ONE OF THE SUCCESS STORIES IN THE PRI PROGRAM

wasn't sure they were program-related *or* handled as investments," he confesses. But after chairing the trustees' PRI committee, Perkins became a strong advocate of PRIs.

"There is a spectrum of ways to help organizations. In many cases, it's clear that the best way has to be a grant; in some a PRI is appropriate. Even a combination may be appropriate. There's no wall between the two," he says.

One of the key points, Perkins notes, is that PRIs are not included in the assessment of the Foundation's overall investment performance. "PRIs are assets, but they are taken out of the investment pool just like our office building. . . . We don't expect the same returns from PRIs as from conventional investments. We do establish loss reserves. By keeping PRIs a relatively small percent of our endowment we are still able to . . . ensure the Foundation's perpetuation by maintaining its real value—and we've helped a lot of people."

Perkins views the risks of PRIs as more than justified by the opportunity to expand the Foundation's resources. "A PRI is really an alternative to a grant. At one end of the spectrum, grants, we expend *all* our funds. You could say of PRI that it's a problem program because we lose 15 percent. Or, you can say it's a great program because we get 85 percent of the funds back to recycle."

For Perkins, the beauty of a PRI is that the *medium* of support fits the *message* of the Foundation's program goals. "Capacity-building is one of our primary goals," he notes. "And we've created a program that develops capacity within individuals and organizations. It helps to teach people how to use credit—how to think differently about financing their organizations."

HISTORY

The Ford Foundation's involvement with program-related investments started with a grant request. During the late 1960s, Louis Winnick, former deputy vice president, reviewed a proposal from a group wanting to provide on-the-job training for minority youths as they rehabilitated a tenement building.

"When I heard their idea, my first question was 'Who owns the building?'" Winnick recalls. "The project was going to end up creating an asset that would generate revenue. It occurred to me that maybe we could have done this as a loan."

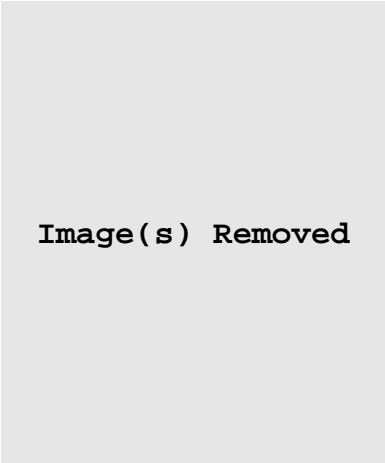
Intrigued with the idea, Winnick began exploring the possibility of initiating a "soft loan" program that could make investments in such ventures as low-income housing and minority businesses.

At the same time, John G. Simon, president of the Taconic Foundation and a professor at Yale Law School, was investigating whether foundations might legally lay aside the stricture of maximum return on investments in order to invest in projects with important social goals. Simon was motivated by requests received by the Taconic Foundation from business ventures in low-income and minority communities, ventures that were stalled by the inability to obtain adequate capital.

"McGeorge Bundy [who was president of the Ford Foundation in 1966] suggested I talk with John Simon," Winnick says. "I'd never even thought about the legal issues. I don't think he was thinking about the economics, so we became natural partners."

A legal definition of PRI was established for the first time in the Tax Reform Act of 1969. Anticipating the Act, Winnick began to develop a position paper for the Ford Foundation's trustees proposing to set aside \$10 million of the Foundation's assets for PRIs. Simon formed the Cooperative Assistance Fund (CAF), a consortium of Ford and other foundations that pooled funds to make PRIs, which now has a twenty-year record of support to business ventures in low-income and minority communities.

While conducting his research, Winnick learned that PRI was not a new concept, but something as old as philanthropy itself.



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*Benjamin Franklin,
America's first social investor.*

***PRIs ARE A WAY
TO STRETCH
LIMITED FUNDS
AND TO ATTRACT
ADDITIONAL FUNDS.***

Benjamin Franklin was probably America's first social investor. In his will, Franklin left 2,000 pounds sterling in the form of a revolving loan fund for young artisans. And in the nineteenth century "Philanthropy at five" was the slogan of a group of wealthy men and women in England and America who undertook ambitious housing reform projects with returns fixed at 5 percent. Among them was George Peabody, an American-born banker who created the concept of a limited dividend corporation to develop and manage low-income housing projects in England.

"This was a century ahead of what was heralded in American philanthropic circles of the 1960s as a bold and praiseworthy innovation," Winnick points out. "Indeed, the older version was more daring since philanthropic funds constituted the *total* investment rather than, as in our time, the relatively small component of a large aggregation of capital supplied by nonphilanthropists."

In the early 1900s housing projects were financed by a few private foundations and donors, including the Russell Sage Foundation, which invested in the development of a modern garden community in Forest Hills, Queens, N.Y. John D. Rockefeller, Jr., financed the Paul Laurence Dunbar Apartments, a cooperative in Harlem where many notable figures of the Harlem Renaissance lived. But the Depression slowed this trend and took most philanthropists out of the social investment business.

In 1968, though, Foundation staff did not base their proposal to the Ford trustees on past precedent. Instead, they made the case that the social needs revealed by the turbulent 1960s and subsequent demands on philanthropic resources required extraordinary responses. The urgency and magnitude of the problems confronting America—poverty, racial tensions, and preservation of the environment—demanded that the Foundation, any foundation, stretch its assets to reach for real solutions. A paper presented to the trustees urged them to "re-examine the tradition that limits our philanthropy to a single mode—the outright grant."¹

The Ford trustees had considered the possibility of social investment prior to 1968 but had not looked upon it favorably. Some members of the finance committee had felt that a clear distinction should be made between the Foundation's investments and its grant-making activities. Winnick thinks that the prior attempt had failed "mainly because it was presented as a plea for transforming our investment officers into philanthropists instead of one for increasing the range and effectiveness of our program officers."

1. *New Options in the Philanthropic Process. A Ford Foundation Statement of Policy*, New York, 1968.

This time the trustees were persuaded by the argument that PRIs would allow the Foundation to stretch its assets. They approved the use of up to \$10 million—about one-third of 1 percent of the total assets at the time—for PRIs in support of high-priority Foundation programs, chiefly minority business development, open housing, the production of low-income housing, and the preservation of the environment. It was expected that most investments would be short-term, extending over one to three years.

The statement announcing the new program said:

The Foundation does not have nearly enough cash to meet all the demands on its agenda, so the program-related investments should be a way to stretch limited funds, as well as to attract the funds of others to good projects. PRIs will arm the Foundation with a range of options for achieving its objectives—the outright grant at one end, something a shade less than a regular market investment at the other, and in between such devices as guarantees, low-return stock and bond purchases, and even interest-free loans.²

Early PRI Experience

The new program was based in the office of the vice president for administration; in other words, it was set apart from the Foundation's program divisions. The PRI office had a small core staff and relied heavily upon outside financial consultants to review and monitor investment opportunities. Proposals that looked promising were forwarded to grant-making staff for comment and "threshold approval," but little sustained interaction occurred between grant-making and PRI staff.

Within two years the PRI staff had made loans to ventures ranging from cattle feeding, fruitcake baking, and steel joist manufacture to fast-food franchising, publishing, public transportation, and catfish raising. Not surprisingly, some of the enterprises supported by PRIs failed.

A report by an outside consultant on the first two years of the program's operation took a dim view of some of the investments. Comments on specific projects included "original projections absolutely unfounded and overly optimistic" and "fantastic assumptions." The Foundation was urged to "stop thinking of PRI as some sort of interminable experiment" and to focus its PRI activity. The consultant suggested the Foundation hire professional loan officers to administer the program.

2. *Program-Directed Investments: A Wider View of Philanthropy*, Ford Foundation Archives: Report No. 001426, March 1968, p. 2.

But reviewers did find that, for each dollar the Foundation had invested, outside sources had contributed an additional five. Ford's funding partners in the early years represented fourteen segments of the economy, including construction, banking, bonding companies, the insurance industry, private investors, church groups, and government agencies.

In assessing those early PRIs, it is important to acknowledge the context in which the Foundation was operating. "We were making substantial loans to small enterprises run by inexperienced entrepreneurs in the poorest neighborhoods," recalls a staff member. "It's surprising that we lost only 35 percent."

And there were some striking successes in the early years. A five-year loan of \$600,000 helped launch the Harvard Community Health Plan, an experimental, prepaid group practice that became the prototypical health-maintenance organization. Trust certificates worth \$1 million from M-REIT, a real estate investment trust, purchased or rented homes for interracial occupancy and provided open-housing opportunities in several communities. Loans to public television stations helped them purchase and renovate facilities.

A program officer recalls these PRIs as providing a basic lesson for the Foundation. "One of the lessons learned from successful loans was that they were most often in fields we knew very well—we knew the people and the players from our grant-making experiences. Many of our early losses were with types of ventures that, in retrospect, we probably had no business being in because we didn't know the field."

Reorganization

Because it was originally conceived as an investment activity, rather than as a supplementary tool for grant makers, during its early years PRI activity was not integrated with the Foundation's grant program. This was due in part to the fact that management responsibility for PRIs was lodged in the office of the vice president for administration, not in the program divisions. Although program staff in the grant-making units often referred potential projects to PRI staff for consideration, the process occurred frequently on an ad hoc basis and did not reflect any systematic exploration of opportunities to use PRIs in carrying out the grant program's mission.

Nonetheless, between 1968 and 1978, eighty-five PRIs totaling \$53.3 million were committed by the Foundation, of which \$34.9 million has been recovered. Of the remaining loans, \$5.6 million remains outstanding and \$12.8 million has been written off.

In the first ten years, PRIs were used predominantly for loans to small businesses, low-income housing, community development

corporations, and other projects consistent with the Foundation's interest in the revitalization of poor, inner-city neighborhoods. These activities received fifty-three loans, compared with eleven PRIs for projects in poor, rural communities and ten for educational and cultural institutions. The predominance of PRI loans for projects in poor, urban communities reflects both the Foundation's programmatic emphasis on such projects and the greater applicability of the PRI tool to investment opportunities in small businesses, housing, and community development.

In 1979 Franklin Thomas became president of the Ford Foundation. From 1966 to 1977 he had been president and chief executive officer of Bedford-Stuyvesant Restoration Corporation, a community development corporation in Brooklyn, N.Y. He had experienced firsthand the important role social investment can play in a community. Grant and PRI funds and public-private partnerships had helped the Bedford-Stuyvesant CDC restore hundreds of units of abandoned housing and create new business ventures that provided jobs to low-income residents. Thomas encouraged PRI staff to develop a plan to reorganize and expand the social investment program. Staff began by evaluating the PRI portfolio, writing off some old loans, and making more use of financial intermediaries to award and administer loans to small businesses and other projects. A staff member recalls: "We discovered quickly that we wouldn't be able to handle a lot of direct investment in ventures. So we turned to intermediaries, who can both administer loan funds and provide technical assistance and backup support." The use of intermediaries remains a strong component of the PRI program today.

The reorganization plan for PRI was implemented between 1980 and 1981. In addition to moving the PRI office from the administrative to the program division, the Foundation placed a new emphasis on the program components of PRI and encouraged a closer collaboration between grant-making and PRI staff.

The years since this reorganization have led to greater integration between PRI and grant programs. Now, a PRI is usually part of a larger grant and loan strategy. The combination of philanthropic tools often increases both program impact and the likelihood of repayment. The closer relationship with grant funding has proven to be a critical step in the development of program-related investments.

***FOR EACH DOLLAR
THE FOUNDATION
HAD INVESTED,
OUTSIDE SOURCES
HAD CONTRIBUTED
AN ADDITIONAL FIVE.***

THE PRI PROGRAM TODAY

PRIs take several forms:

- Direct loans.
- Equity investments.
- Loan guarantees.

As of September 1991 the Ford Foundation had made 229 program-related investments totaling nearly \$196 million. Of total investments, \$71.3 million has been repaid and \$17.2 million written off.

Projects supported by PRIs have encompassed all of the Foundation's programmatic interests—urban poverty, rural poverty and resources, rights and social justice, governance and public policy, education and culture, and international affairs. Borrowers have been located in the United States and in developing countries. Most organizations receiving PRIs are either current or past Foundation grant recipients.

Currently, the Office of Program-Related Investments makes approximately \$15 million in investments annually. PRIs are funded out of a \$130 million set-aside from the Foundation's corpus. Over the years the trustees have increased the allocation to this level from \$10 million. It is now a little more than 2 percent of the Foundation's current asset base. (For a five-year financial summary of PRIs, see Appendix, page 57.)

PRI operates as a revolving fund. The \$130 million ceiling applied to an earmarked portion of the corpus disciplines PRI activities by tying future availability of loan funds to staff decisions on the terms for new PRIs—and on how well they monitor payback and resolve problems in troubled PRIs.

PRIs take several forms:

- *Direct loans.* The most common PRIs, loans have been made for such purposes as mortgage financing and predevelopment costs of housing and business ventures.
- *Equity investments.* The Foundation has purchased common and preferred stock in business ventures and bank holding companies.
- *Loan guarantees.* The Foundation has served as guarantor on a loan or line of credit given by another financial institution to encourage a private lender to become involved.

Interest rates and terms of loans made by the Foundation are negotiated on a case-by-case basis. Interest rates vary based on what

the project can bear, but the rate is always considerably less than what a market rate investor would charge. Repayment terms are usually less than ten years and average seven years.

Although PRIs are made out of the Foundation's asset base, any losses are funded out of grant-making budgets. When a PRI is made, a loss reserve equal to 15 percent of the PRI is funded from the Foundation's grant budget. Financial performance of loans is reviewed quarterly by staff. If the condition of a PRI deteriorates, the reserve level is raised and the necessary funds are transferred from grant budgets to the loss reserve fund. Therefore, when actual losses occur, the amount needed to recognize the loss has already been added to this fund.

Repayments of principal on PRIs are credited to the set-aside and become available for new PRIs, but earnings are returned to the Foundation's corpus. PRI disbursements are counted as qualifying distributions toward satisfying the payout requirement that the Internal Revenue Service imposes on private foundations. PRI repayments increase the payout requirement just as would an unused grant returned to the Foundation.

How a PRI Is Made

The Ford Foundation is one of very few foundations that has a specialized office and staff for PRIs. Other foundations often use outside consultants, financial intermediaries, or trustees and administrative staff with financial expertise to assist with PRIs. The Foundation's PRI activity is currently administered by six program investment officers. Staff tend to be people who have spent part of their careers in the business world, often in banks or investment-related departments of companies, and part in nonprofit organizations or government agencies.

The PRI staff are quick to point out that making program-related investments does not require a degree in finance or accounting. What is needed, they say, is the willingness to walk between the two worlds of finance and social purpose.

PRI requests are reviewed by both grant and PRI staff to ensure that the proposed deal is both financially sound *and* addresses programmatic interests. This is an iterative process. Commenting on his experience reviewing a potential PRI at the request of a grant-making colleague in Senegal, a program investment officer says:

My approach was very technical: "I'm the expert on credit and I'm here to ask the hard questions." When I got to Senegal, I began to really understand the program aspects—the cultural context of the deal. I went to look at a credit program and I began to under-

***WHAT IS NEEDED IS
THE WILLINGNESS
TO WALK BETWEEN
THE TWO WORLDS
OF FINANCE AND
SOCIAL PURPOSE.***

stand a membership organization and its goals. It taught me the importance of looking at program goals first.

People often come to PRI with a financing technique they want to try. To see if the technique makes sense, you have to look at the program. Usually, when you do that, the technique changes.

At times program officers have split their time between a grant-making office of the Foundation and the Office of Program-Related Investments. This is part of a Foundation strategy to continue integrating the work of the two units.

The involvement of PRI staff with a project begins with an inquiry or proposal to the Foundation. Many requests are referred by program officers whose grant-making activities help identify a project with PRI potential. Sometimes the initial review does not result in a PRI but rather in the identification of another, more appropriate way to finance the project. Recently, for example, PRI staff went to an overseas field office to review the business plans of a nonprofit venture at the suggestion of grant-making staff. They recommended grant support to develop a business plan that attracted another funder willing to support the project on a grant basis.

A former director of the Foundation's Rural Poverty and Resources program put it this way: "There are projects we've looked at together, where it turned out that grant funding was the way to go—a clearly identifiable repayment source wasn't available, for example. But the process of evaluating whether this is a good PRI opportunity lends strength to the grant analysis."

The review of each PRI request includes a look at the overall financial health of the requesting agency and its financing needs apart from the requested loan. In many cases, a grant for operating expenses or to help build financial reserves may be recommended as part of the investment package.

The Foundation's financial services staff also occasionally assist in PRI transactions. They have helped PRI staff review the terms of deals and have helped some PRI recipients to locate appropriate banking services. The treasurer and director of financial services for the Foundation says that he and his staff enjoy working with the PRI office. "Our staff generally want to know more and to become involved with the program work of the Foundation, and this is one way to do it." In fact, many foundations with small program staffs use their financial services staff to make PRIs.

In the course of reviewing a project, PRI staff may meet with other potential backers of the project and help the applicant package its request to other funders. Kirsten Moy, vice president of the Equitable Life Assurance Society of the United States, which has been a partner on many PRI projects, spent a year in the PRI office of the Ford Foundation before taking her present position at Equitable.

“It’s good to have different funding partners involved in projects,” Moy says. “You need different pieces of financing and, thus, players who have different resources and objectives.” Moy says that each partner in a social investment has to decide on the level of risk its institution will assume. “What is appropriate for Ford may be inappropriate for Equitable,” she says. “At Ford, I felt I could take greater risks. The worst thing there was *not* trying to do something; the achievement of social purpose seemed to be the most important thing. At Equitable, we’re a business. Here, one of the worst things is losing our money.”

As terms for a possible loan or investment are negotiated, the Foundation’s legal counsel become involved to identify any legal issues, help define loan terms, and draft commitment letters. Counsel also obtain outside legal opinions on PRIs when needed and, in rare cases, have supervised bankruptcy or reorganization filings when investments have failed.

Foundation counsel report that they have faced few legal difficulties when structuring PRIs to meet Internal Revenue Service standards. According to one of the Foundation’s resident counsels, “Most situations are clearly covered by the examples provided in the Treasury regulations.” Once the terms of the deal have been negotiated with the applicant, the PRI is submitted for approval to the president of the Foundation, following the same procedures used for grant recommendations.

When a PRI is approved, a commitment letter outlining the terms of the investment is sent to the applicant. The letter may specify special requirements that must be met before funds are released. Since PRIs are often made at an early stage of a project to assist the borrower in negotiations with other potential financing sources, PRI staff must wait for those negotiations to be completed before investment agreements can be executed. Reporting and repayment requirements are included in the investment agreements, and PRI staff regularly review the progress of the project, payment status, and financial reports.

***IT IS IMPORTANT
FOR A FOUNDATION
TO DECIDE HOW
MUCH RISK IT IS
WILLING TO TAKE.***

Managing Risk and Loss

Among the issues that do not arise in grant making are: How much, if any, of a foundation's assets are trustees willing to risk? How much security do they want? Is the foundation willing to consider foreclosure if a venture fails?

"From the beginning, we faced the occupational hazard of all PRIs," recalls one of the program's founders. "If the deal is too risky, you don't want to do it, and if it's *not* risky, why do it?"

But all actions taken by a foundation, whether grants or PRIs, involve some level of risk. Can the program be carried out within budget? Will the grantee be able to accomplish its goals? If the goals are accomplished, will they lead to the expected level of impact? For PRIs, the foundation also runs the risk that it might not recover its funds. Even if the programmatic purpose is achieved, a project might not reach its financial targets and therefore might be unable to repay its PRI. For these reasons, it is important for a foundation considering making PRIs to decide how much risk it is willing to take and how it will manage that risk.

The Ford Foundation has chosen to take a fairly high-risk profile in its PRI program compared to commercial lenders and has established several mechanisms to manage that risk. A recovery rate of 85 percent was targeted, in an effort to balance the goal of providing the most needed type of PRI financing (often unsecured investments made in the early stages of a project's development) with the advantages to be gained by recycling PRI funds. As noted above, to cover the expected 15 percent loss rate without impairing the value of the Foundation's corpus, a loss reserve is established with grant funds. In addition, many PRIs require that the recipient maintain its own loss reserve fund.

Total actual and anticipated losses of the Ford Foundation's PRI program during the past twenty-three years have been 21.6 percent. On investments made during the program's first five years, the loss rate was 35.4 percent. For investments made since fiscal year 1982, the rate is 17 percent.

The reduction in losses reflects the fact that PRIs are no longer made in privately owned small businesses. Rather they are now most often made in areas where the Foundation has program expertise or to intermediaries with special expertise. The reduction also reflects the improved monitoring of PRIs and the sharper distinctions made between what should be funded with debt and what should be supported with grants. Every recommendation for a PRI includes an assessment of risks, factors that offset them, and steps that will be taken to mitigate the risks.

Nearly one-half of all PRI losses in the program's history came from investments in small-business ventures. A review of the Foundation's loss experience conducted in the early 1980s provided some important lessons. According to the director of the PRI office:

Unless you know an industry well and are prepared to take an active management role, it's very difficult to invest directly in small businesses. Our funding was sometimes inappropriate; business ventures that met our program goals (those owned by minorities and/or located in low-income communities) needed equity financing, and the PRI program could only provide medium-term debt. Also, the ventures were often far removed from our office in New York, complicating the already difficult tasks of monitoring and problem-solving that make up a successful business investment program.

To address these problems, the Foundation has made increasing use of intermediaries to administer loans and investments in small-business development.

Most PRIs are general recourse loans to the borrowers. When collateral of some value is available, the Foundation usually takes a security position against that asset. In many of its PRIs, the Foundation agrees to take a secondary position against the collateral that secures the loan.

The PRI director continues:

Since we are risk-capital providers, we are rarely well secured and will therefore inevitably suffer capital losses in the event of project failure. The risk profile of our investments is similar to that of venture capitalists who provide seed capital to new ventures. But venture capital investors enjoy the prospect of large capital gains on a few of their investments, and if a venture fund is successful, those gains will more than cover losses on other deals. Since the Foundation's PRI program emphasizes programmatic goals rather than financial gain, we do not make investments with significant profit potential. Therefore, the PRI program will suffer some level of capital loss. But these losses are considered a cost of the program and weighed against the benefits of recovering and recycling the great majority of PRI funds. Certainly recovering 85 percent of a PRI from a project that accomplished an important program goal is less costly than if the total project had been supported with non-recoverable grant funds."

***A CONSCIOUS
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Six Lessons

The lessons learned from managing risk and loss can be summarized as follows. First, PRI's greatest impact and most impressive repayment record have been in projects that are related directly to the Foundation's grant programs. Like private investors, Foundation staff must know the market in which a project operates in order to assess the feasibility of its plan. Specialized consultants are still often needed, but a grant maker's experience in a particular field makes it easier to determine the key questions and assumptions and whom to approach for assistance. Also, many PRI projects require layers of social and conventional investments. Foundation staff familiar with a particular program area serve an important role identifying other public and private investors needed to support an initiative.

The second lesson is also related to the importance of program focus. Staff who administer PRIs must have a strong knowledge of the program areas of the Foundation as well as skills in financial analysis in order to assess the potential social impact of an investment. Without this program orientation, projects may be chosen because they are loan opportunities and not because they are part of a program strategy.

The third lesson is that borrowers almost always need project equity, mostly in the form of grants, for some aspect of their work. Occasionally project equity comes from other sources, but often the Foundation is asked for this support as well as for a PRI. If a project is related directly to the Foundation's program interests, it is easier to provide such support. Some equity, such as funds for a loss reserve of a loan fund intermediary, is difficult to raise elsewhere. Judiciously applied grant funds help improve the likelihood of the project's success and repayment of the PRI. Grants may also serve as seed capital to test a new project before a loan is made and the project "goes to scale" with a larger financial investment.

The fourth lesson is the importance of thinking through the Foundation's willingness to obtain collateral as security in order to have "a seat at the table" with other creditors as they discuss a troubled loan, and to foreclose to recover assets in a "worst-case" scenario. As a secured investor knowledgeable about a social problem or program, the Foundation can play a critical role in helping creditors determine whether a troubled loan might be saved by restructuring it. In the event a project fails and the best outcome is to liquidate secured assets, the Foundation may want to consider foreclosure as an option or face the problem of sending a mixed message to other borrowers about repayment.

Fifth, as program areas mature, it is important to find and sup-

port intermediaries that can carry out specialized social investment activities. Although the Ford Foundation has learned much from direct investing and plans to continue in that role, it has reduced its risks and expanded its coverage by supporting other for-profit and nonprofit institutions that have specialized lending capacities. Foundation staff point out that working through intermediaries offers the following advantages:

- Intermediaries serve as “wholesalers” who can process large numbers of small loans or investments more efficiently than the Foundation could if it considered each individually.
- Intermediaries can develop expertise in a particular field or region that the Foundation cannot afford to develop.
- The support of intermediaries helps develop institutions that can raise capital and distribute it to projects.

However, when choosing an intermediary, it is important to consider whether it has the ability to develop a sufficient capital base. An intermediary that plans to make investments over the long term must be able to secure capital from a variety of sources and build its own financial strength through grants received or earnings on investments.

Sixth, foundations may find that supporting social ventures stimulates rethinking of many of their assumptions about nonprofit financial management. For example, foundations may tend to look at cash reserves as idle money that should be spent on projects. But this makes it very difficult to build the financial strength necessary for independence. Few venture capital funds or private banks have their funds entirely invested. Typically, some portion is placed in low-risk, liquid investments to provide a steady source of income and the flexibility to invest in extraordinary or unanticipated opportunities. “Reserves aren’t idle,” says Thomas Miller, the Ford Foundation’s PRI director. “They are like a standing army: You have to have it ready when it is needed.”

Staff have found that getting involved in PRIs means addressing these and other questions about how the nonprofit sector manages risk and loss. Grappling with these issues has led to the realization that a conscious and explicit effort, including the willingness to go beyond traditional grant support, is necessary to build financially strong nonprofit institutions.

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PROJECT PROFILES

The case studies presented in this section reflect the range of projects supported by Ford Foundation PRIs during the past twenty-three years. As the cases attest, PRIs can be used in a variety of ways: to build housing units, generate jobs, provide office facilities for grantees, support the arts, and create new financing mechanisms and institutions, among other things.

Some of the PRIs described involved ingenious financing mechanisms and multiple partners. Others were simple loans. But the financing techniques were not as important as the *programmatic* impact the availability of a flexible funding mechanism had on recipient organizations. Each PRI made something happen, helped an organization on to its next stage of development. And the discipline of applying for and paying back a loan often caused recipients to think about their programs and their management in a new way.

Some of these projects started out as a request for a program-related investment, and others began with a grant request. In both cases, the first step was to ensure that the proposed project fit the Foundation's program interests. The decision to make a PRI resulted from a process that looked for the most appropriate vehicle to support the project. For many of the projects described, that vehicle was a mix of grant funds, a PRI, and management assistance.

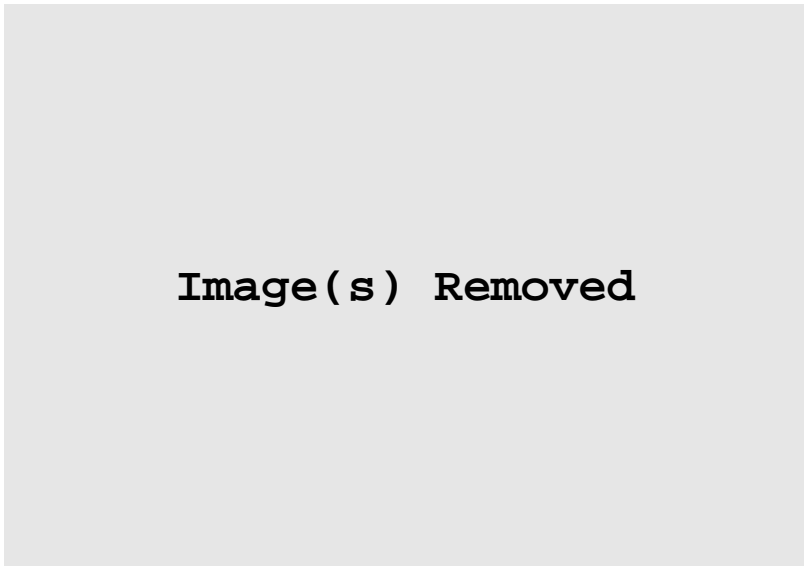
Each of the case studies that follow includes a summary of the terms of the PRI as well as a discussion of the programmatic importance of the activity and the financial risks of the PRI. In addition, one or more structural features or "deal points" of the investment are highlighted for each case. The projects are grouped into three separate categories to illustrate (1) the variety of program interests PRIs can be used to address, (2) the variety of structures that PRIs can assume, and (3) ways PRIs can be used to complement grant-making strategies.

VARIETY OF PROGRAM INTERESTS AND THE PRI

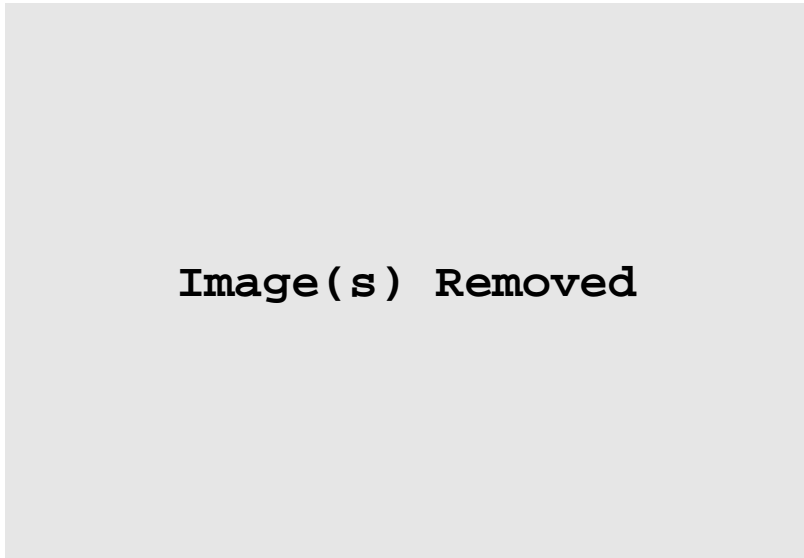
These first three cases illustrate the variety of program interests that PRIs can address. Research Libraries Group (RLG), presented first, is a consortium of leading educational institutions from around the United States; the Young Women’s Christian Association (YWCA) of Jersey City is a social service provider in an inner-city neighborhood; and the Mountain Association for Community Economic Development (MACED) is an economic development organization in rural Kentucky. The PRIs served very different functions for each of the three organizations, but in each case the PRI was used in a way that enhanced the borrower’s capacity to carry out its programmatic mission.

The Research Libraries Group, a consortium of leading U.S. universities and research institutions, offers specialized bibliographic services to its members.

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Lunch is served daily to senior citizens at the Jersey City YWCA.



The Mountain Association for Community Economic Development has helped make private home mortgages available to low-income buyers in eastern Kentucky.

RESEARCH LIBRARIES GROUP (RLG)
Mountain View, California

1980

Amount:	\$1.7 million
Purpose:	Working capital for RLG's automated information system
Source of repayment:	Revenues from the sale of its services to member libraries

The average research library acquires 25,000 books a year. The cost of acquiring and cataloging these and other holdings is a major expense. A PRI helped establish a computerized data base that provides these services more efficiently and cheaply to many of the nation's largest research libraries.

When it was founded in 1974, the Research Libraries Group was a small, nonprofit organization consisting of four major research institutions. Today, RLG is a consortium of thirty-six major universities and research institutions that operates cooperative programs designed to address the specialized needs of research collections. Headquartered in Mountain View, Calif., RLG coordinates and manages programs in collection development, shared access, and preservation of research materials.

RLG's automated information system, the Research Libraries Information Network (RLIN), combines data bases and computer systems to support RLG's cooperative programs. As a "bibliographic utility," RLIN provides bibliographic information to RLG members and nonmembers to assist them in building and maintaining records of their collections, locating materials for library patrons, and answering researchers' questions. RLIN services include data-base searching, cataloging, and acquisitions, archives management, and interlibrary loans. RLIN services and other cooperative programs offered by RLG make such activities less expensive and more efficient. Both members and nonmembers pay standard fees for the uses they make of RLIN.

In 1978 RLG began to explore the possibility of developing an automated bibliographic system and the expansion of its membership base. RLG was convinced that a partnership of peer institutions could solve many of the unique problems of research libraries. To undertake the expansion plan, RLG was granted a total of \$3.3 million from Carnegie Corporation, Andrew W. Mellon Foundation, and four other foundations.

After an intensive analysis of RLG's business plan, Ford Foundation staff in 1980 recommended a \$1.7 million PRI loan to RLG for working capital to expand its operations. An additional \$650,000 in grant funds was designated as a loss reserve. The Ford PRI loan, together with a \$500,000 PRI loan from Carnegie Corporation, helped launch the next critical phase of RLG's expansion: an increase from twenty-two to twenty-nine members, which was the level at which operations were expected to break even. The terms of the Ford Foundation PRI loan were as follows:

- Term:** Six years.
- Interest rate:** 8 percent.
- Repayment schedule:** Quarterly payments that added annually to \$320,000, \$480,000, \$640,000, and \$180,000 in years three through six of the loan.
- Security:** None.
- Disbursement schedule:** The Ford and Carnegie loans were each disbursed in two phases, with specific membership and operating goals required to be met before each disbursement.

Deal Point

The risk of this PRI rested entirely on RLG's successful management of its expansion. The venture involved all the challenges of running a business, including the achievement of marketing goals, cost containment, and the development of competitive and high-quality "products and services." From the start, PRI staff recognized that certain aspects of RLG's business could not be funded by operating revenues, and these special activities would continue to need grant support. Although staff assisted RLG in developing a realistic business plan, the Foundation acknowledged the risk of this PRI by establishing a substantial loss reserve.

The Foundation's participation as a lender resulted in assistance to RLG beyond the funds provided. When operating goals for the second phase of the Foundation's disbursement were not met, the Foundation insisted that member institutions step in with loans and pre-purchase agreements. The need to meet a rigorous schedule of principal and interest payments also provided an impetus for frequent communication about operating problems. RLG staff believe that obtaining PRI support forced them to examine the assumptions in their business plan closely and to become more disciplined as an organization. The reports required by Ford and Carnegie became the impetus to create an internal management information system.

Over 60 percent of the Ford Foundation PRI loan has been repaid and RLG now operates on a break-even basis. It continues to evolve in response to the changing bibliographic needs of its 104 member institutions.

YWCA OF JERSEY CITY (THE Y)
Jersey City, New Jersey

1981

Amount: \$1 million

Purpose: Bridge loan to finance the cost of renovating the space in which the Y carries out its community programs, and to complete a financing package that made possible the construction of eighty housing units for the elderly and handicapped

Source of repayment: Proceeds from the sale of the building and a YWCA capital fund drive

The YWCA of Jersey City looks like a well-kept apartment house. Its fresh paint and landscaping help it serve as an anchor in its residential and commercial neighborhood.

During the 1970s, the Y faced the dual challenges of a deteriorating physical plant and the rapidly changing needs of its constituency. Once known as a recreational and social center for women employed in nearby defense factories, during the 1970s the Y introduced a diverse array of social services to meet the needs of community women and their families. Programs eventually included a group home for adolescent girls, a learning center for at-risk children, a shelter for battered women, and a family advocacy project.

The Y's six-story building, however, was badly deteriorated and could not keep pace with its programming needs. Nor did the Y have the financial resources to address the problem. "We considered abandoning the building," says Director Martha Lewin, "but we couldn't even afford the cost of boarding it up."

Lewin and her trustees started to explore a joint partnership with a private developer to rehabilitate the building into eighty units of Section 8 subsidized housing for the elderly and handicapped as well as office and program space for the YWCA. After lengthy negotiations, it found a developer, McCormick Baron Associates (MBA), and obtained a commitment from the New Jersey Housing and Mortgage Finance Agency to issue \$6.8 million in bonds for the project—the first time that financing for housing renovation and human services had been combined by a state housing finance agency.

In order to obtain equity investment for the project, MBA set up a limited partnership to acquire the building and attract investors. The investors would contribute \$1.1 million over five

years and, in return, would receive the tax benefits of ownership and a portion of the cash flow from the housing units. Over time, one-half of the equity investment, or “syndication proceeds,” would be paid to the Y and the other half to the developer, MBA. In return for this promise to pay, plus an additional \$500,000 from the partnership at the beginning of construction, the Y would sell the building to the partnership. The partnership would, in turn, lease the program space back to the Y. The Y’s lease payments to the partnership would serve to repay its portion of the Housing and Mortgage Finance Agency loan.

Just before the deal was to close, the state imposed a new requirement. To qualify for the funds to renovate their space, the Y would have to place the full amount of the non-housing portion of the financing, a sum of nearly \$2 million, into a security account, and assign it to the Housing and Mortgage Finance Agency.

“I thought we were dead in the water,” recalls Lewin. “It was devastating, to have come so close.” A bank loan, without tangible collateral, was out of the question. McCormick Baron suggested they find an institution that would lend against the Y’s future syndication proceeds and a capital drive, and assisted Lewin in making contact with the Ford Foundation.

The Y knew it would have \$500,000 from the partnership at the beginning of construction. In addition, it had already raised \$240,000 in grants and donations. It approached the Foundation for a \$1 million bridge loan to complete the security account. The terms of the loan made by the Foundation were as follows:

Term:	Five years.
Interest rate:	8 percent, payable at the end of the loan period.
Repayment schedule:	Uneven principal payments in years one through five, plus interest of \$184,000 in the last year.
Security:	<ol style="list-style-type: none">1. assignment of the \$550,000 in syndication proceeds due to the Y from the partnership;2. assignment of the escrow account used to receive pledges from the capital fund drive.

Deal Points

1. In reviewing the risks of this loan, PRI staff considered three factors. The first was the risk associated with the Y's ability to raise an additional \$360,000 in pledges over the five-year term of the loan. The Foundation evaluated this risk against the Y's track record in fund raising, its marketing strategy, and its standing in the donor community. The second factor was the risk that the project might not be well-managed and construction might not be completed. To assess this risk, staff reviewed the experience of the developer, MBA, and verified that it had a good track record with other housing projects. The third risk concerned the viability of the Y's programs, which were heavily dependent on public-sector funding. Staff found that the Y was in a good position to compete for funds and had designed a plan to accommodate the possibility of shrinking budgets. Because it is familiar with the risks involved in fund raising, subsidized housing, and government funding, a foundation is likely to be more comfortable with this type of loan than would a conventional lender.

2. The loan was structured to accommodate the uneven flow of the Y's sources of repayment, with the largest payments timed to coincide with receipt of the syndication proceeds. Interest payments were deferred until the end of the loan, when the level of pledges due would likely be the highest.

3. This project represented a unique opportunity to create a permanent asset in which the Y could operate its programs. In addition, the need to create a security account for the bond financing had a serendipitous benefit for the Y's future operation. As the bond financing was repaid to the state, the security account became part of the Y's permanent endowment. "That's the best part of the deal," says Lewin. "Our ongoing ability to meet some of our operating costs is assured."

The unconventional structure of this PRI and the nature of the collateral illustrate the flexibility with which a PRI lender can respond to a potential deal. In Martha Lewin's opinion, "This deal would not have gone through without the PRI. It wasn't just that it made loan funds available. The risk analysis process, demonstrating the viability of a PRI, enabled us to frame the best possible deal with the developer." The Y has repaid its PRI loan and has gone on to develop several other projects.

**MOUNTAIN ASSOCIATION FOR COMMUNITY
ECONOMIC DEVELOPMENT (MACED)
Berea, Kentucky**

1983

Amount: \$925,000

Purpose: Partial financing of costs of issuing a mortgage revenue bond for low-income housing in twenty counties of eastern Kentucky

Source of repayment: Interest earned on a subordinated bond purchased by MACED as part of the program and refinancing of the bond itself at the end of the loan term

The availability of private home mortgages is something that most Americans take for granted. But in some isolated, rural regions of the country, affordable financing for home ownership has been virtually unattainable. This PRI helped make private home mortgages available on conventional terms in eastern Kentucky.

The Mountain Association for Community Economic Development, an Appalachian regional economic development group, organized twenty-seven banks in twenty counties to issue a \$16 million tax-exempt revenue bond for home mortgages. MACED initiated the project after a telephone survey of 106 banks in the region revealed that only eighteen made standard, single-family mortgage loans. The few available home mortgages typically had ten- to fifteen-year terms and required a 33 percent down payment, making home ownership impossible for a majority of families.

Although the state of Kentucky had previously issued a single-family mortgage revenue bond, almost none of the money went to the rural eastern part of Kentucky. Small banks there that had attempted to use the state bond found that the bond's underwriting standards were ill-adapted to the realities of rural communities.

The bond program organized by MACED was intended to be issued at the county level and then allocated to the twenty-seven banks participating in the consortium. The banks would screen and originate loans to families and their mortgage payments would be used to pay debt service on the bonds. Because the bonds would be tax-exempt, thirty-year instruments, families could receive thirty-year mortgages, at competitive rates, with a 5 percent down payment. These terms would make home ownership available to families earning as little as 71 percent of the state's median income.

Typically, the costs of organizing and issuing bond programs of this type are funded through commitment fees paid by bank participants. The fees are passed along to home buyers in the form of “points” on their mortgages, sometimes as much as 3–4 percent of the mortgage amount. In order to induce banks to participate in the program but not increase costs to the ultimate borrowers, MACED hoped to finance most of the up-front costs of issuing the bond itself, charging the banks only a 1 percent fee. MACED approached the Foundation for help in financing these costs. MACED also requested that the Foundation provide a special pool of funds to offer a further subsidy to lower-income borrowers. The subsidy would gradually reduce over a three- to seven-year period.

The terms of the loan the Foundation made were as follows:

Term:	Five years.
Interest rate:	3 percent.
Repayment schedule:	Lump sum at the end of year five.
Security:	Assignment of the subordinated bond and assignment of a sinking fund to receive interest payments on the bond.

Deal Points

1. The major risk identified by PRI staff was the possibility that banks might not be able to originate all the mortgages allocated to them, thereby leaving MACED without the means to recover the costs of issuance. Several circumstances helped offset this risk. First, banks in the consortium had requested allocations of more than twice the amount contemplated by the program. Second, MACED planned to undertake a market study for the bond rating agency that would indicate whether sufficient demand existed. Third, the mortgage “product” would be highly competitive with the traditional short-term, high-down-payment mortgage available in eastern Kentucky.

2. MACED's investment in this program would take the form of a \$675,000 subordinated bond. Interest earned on the bond over the first five years would repay a portion of the Ford PRI, but the bond itself would have to be sold to repay the rest. This was a new type of financial instrument, without an established market. Although the bond was assigned to the Foundation, there was no certainty that the bond could be sold at year five. This type of risk is characteristic of a PRI.

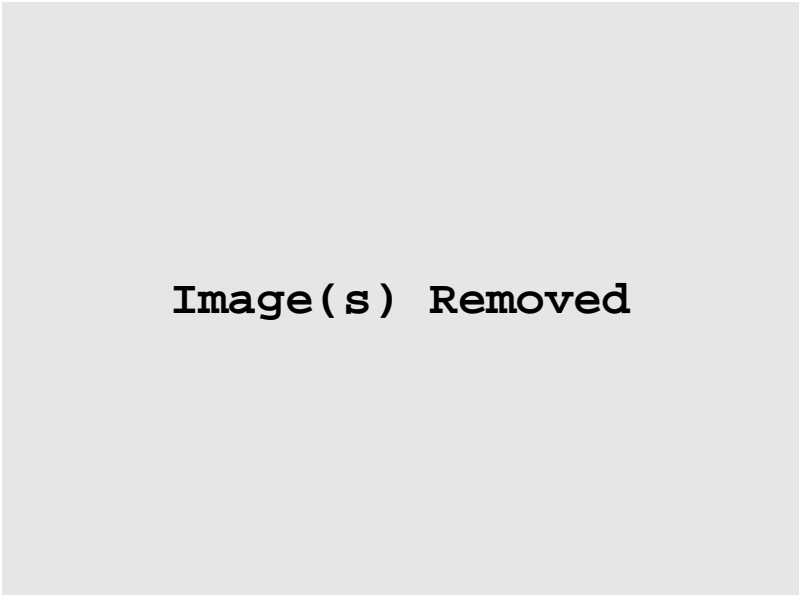
3. The special pool of mortgage subsidy funds gave MACED an additional tool with which to fulfill its objective of targeting mortgages for lower-income families. It gave MACED the opportunity to test whether this mechanism made sense for future bond issues in the region or as part of a national housing policy.

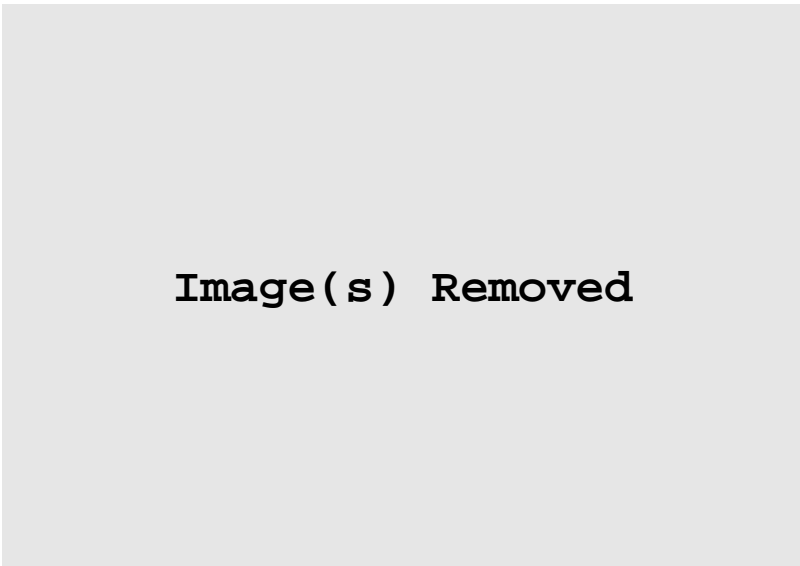
The PRI helped MACED accomplish an important part of its programmatic mission. The bond program itself not only brought new credit on good terms into the region, but it also substantially strengthened MACED's relations with local lenders. MACED was able to repay the PRI on schedule and carry out a second successful bond program without PRI assistance.

VARIETY OF STRUCTURES AND THE PRI

The next three case studies illustrate the variety of structures that a PRI can assume. A PRI can take the form of a recoverable grant executed with a letter agreement. The PRI for the Grameen Bank illustrates this approach. Many PRIs, like the one to Tacolcy Economic Development Corporation (TEDC), take the form of a direct loan to an organization to carry out a single project. Other loans are made to an intermediary organization, which in turn relends the funds to many other smaller organizations. For example, an intermediary like the Local Initiatives Support Corporation (LISC) can provide specific expertise in a particular program area and is staffed to originate and monitor many small loans.

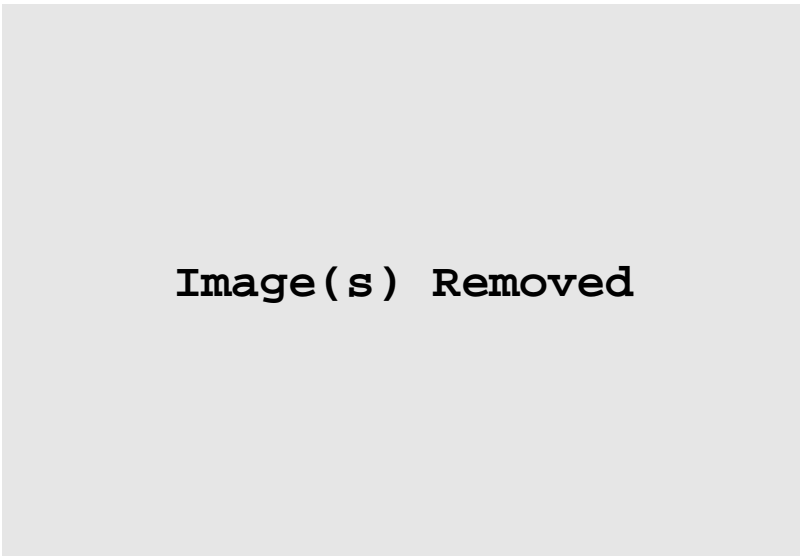
A borrowing group meets with a Grameen Bank representative in a Bangladesh village.





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Edison Gardens, a low-income housing complex sponsored by Tacolcy Economic Development Corporation in Miami.



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Apartments in Chicago rehabilitated by a community organization with help from the Local Initiatives Support Corporation.

GRAMEEN BANK
Dhaka, Bangladesh

1981

Amount: \$770,000

Purpose: Partial guarantee of defaults under an experimental rural credit program for the landless poor

Source of repayment: Recovery of loans made by the program

The people in over half the households in Bangladesh are landless poor who patch together a living from a variety of seasonal trades, crafts, and service jobs. Most are denied access to credit, and much of their profit goes to moneylenders, who charge as much as 10 percent interest per week. Women, excluded from many occupations and educational opportunities, are often the worst off of all. Grameen Bank was founded by Muhammad Yunus, an economics professor at Chittagong University, to help these people.

Yunus concluded that the availability of affordable credit was key to the advancement of the landless, but without collateral they could not qualify for conventional bank loans. In 1977, with partial grant support from the Foundation, Yunus began an experiment to provide small unsecured loans to the landless for such projects as rice husking, livestock rearing, carpentry, and petty trade. A key feature of the Grameen approach is the “borrowing group,” in which members assume collective responsibility for repaying loans. The experiment showed that, when organized in groups of five to ten, with peer pressure substituted for collateral, the participants repaid over 98 percent of the funds they borrowed.

At the beginning only two members in each group are permitted to borrow. Once the first two are repaying regularly, other group members may apply for a loan. Each loan application is reviewed by all group members, and the average loan is \$70. Borrowers are also required to deposit a small amount in a group savings account and in a fund for emergencies. These reserves are controlled by the group. A borrower in default may forfeit the contributions he or she made to the group funds. Other members of the group are ineligible for any new loans until payments on all the loans are current.

The experiment begun by Yunus in 1977 was picked up by the central banking authority of Bangladesh and replicated through cooperating commercial bank branches. By 1981, twenty-five cooperating commercial bank branches were participating and about

\$2 million in loans had been disbursed to 15,000 men and women.

In 1981 Yunus planned to expand the project from twenty-five to 100 bank branches in order to reach 100,000 borrowers. But the commercial banks that provided the field staff and the loan capital were concerned that the expansion would be costly and too risky. In order to induce the commercial banks to participate, Yunus approached the Foundation to provide a 10 percent guarantee of loan defaults, thereby reducing the potential loss of the participating banks. The Foundation provided the guarantee in the form of a recoverable grant, part of which was made through the Foundation's field office in Bangladesh, and part through the Office of Program-Related Investments. The terms of the recoverable grant were as follows:

- Term:** Three and one-half years.
- Interest rate:** None.
- Repayment schedule:** The availability of the guarantee would decline over three years, with any funds not needed to pay defaults returned to the Foundation at the end of the term.
- Security:** None.

Deal Points

1. Because the underlying loans had a high risk and recovery of the loans that went into default was unlikely, this PRI was structured as a recoverable grant. The recoverable grant mechanism also made sense for this project because of the inherent complexity of negotiating loan documentation across different countries, as well as the difficulty of repaying a loan in dollars with a fluctuating local currency.

2. The risks in this project were offset by the structure of the borrowing groups and the operating principles of the project: close supervision of borrowers, peer pressure as a substitute for loan collateral, small but regular loan repayments, and regular savings to build up members' own capital. The loan default rate the banks feared never materialized and the recoverable grant was not used.

The recoverable grant to the Grameen Bank came at a critical point in its expansion plan, enabling the bank to become an autonomous financial institution in 1983. With an additional PRI and major support from other international donors, the Grameen Bank now has 900 branches, which make small loans to nearly one million borrowers.

A recoverable grant is useful in a number of circumstances, such as when a project carries a high degree of risk. The recoverable grant to the Grameen Bank was used to support a high-risk expansion plan in a setting where a more formal loan structure would have been difficult to administer. In 1984 the Foundation modified the grant to permit the Grameen Bank to undertake another experiment: a revolving loan fund for larger group-based enterprises.

**TACOLCY ECONOMIC DEVELOPMENT
CORPORATION (TEDC)
Miami, Florida**

1986

Amount:	\$1,350,000
Purpose:	Mortgage financing for a 121-unit, low- and moderate-income rental housing project
Source of repayment:	Operating revenues from rents during the term of the loan and refinancing at maturity with conventional debt

The story of Otis Pitts and Tacolcy Economic Development Corporation illustrates a phenomenon Neal R. Peirce and Carol F. Steinbach describe in their book on community development corporations (CDCs):

. . . this movement, largely invisible to the society at large, is quintessentially American. It mirrors the qualities of our society that so impressed Alexis de Tocqueville in the 1830s: our penchant for innovative civic association, our belief that individuals can bring about change, our openness to risk taking and to bridging lines of class, ideology, and party.³

CDCs seek to develop underserved communities like Miami's Liberty City by creating housing and job opportunities.

When Otis Pitts was a police officer in the 1970s, his beat was in Liberty City. Part of it included a youth center, and he often stopped by to visit its director. Eventually he became involved in its programs. One day, the director asked Pitts if he would take over the center, if she raised the money for his salary.

"I never thought she'd do it," he says now laughing, "but she did, and I was young enough at the time. I thought I could always run back to the police if it didn't work out."

That was the start of Pitts' transformation from cop on the beat to housing and shopping center developer. In the nine years Pitts ran the youth center, he saw the problems in Liberty City worsen. In 1981 riots in the neighborhood brought out the National Guard. In the aftermath, Pitts realized that Liberty City needed a community development organization in addition to a youth center.

3. Peirce and Steinbach, *Corrective Capitalism*, p. 9.

Pitts' first philanthropic support was a grant from the Local Initiatives Support Corporation (LISC), which enabled him to travel the country looking at various community development projects that might serve as models for revitalizing Liberty City. After he returned from that trip Pitts incorporated the Tacolcy Economic Development Corporation.

The new CDC's first major project was Edison Plaza, a neighborhood shopping center created from an abandoned supermarket with grant and loan funding from LISC, the City of Miami, Dade County, the federal Economic Development Administration, and the Business Assistance Center.

"We felt that commercial and residential revitalization had to go together in Liberty City," says Pitts. In South Florida, good quality rental housing for low-income people is scarce, and it had been decades since a new rental housing development had been built in Liberty City. Tacolcy began to look for a housing development project.

TEDC formed a joint venture with a private minority-led developer, put together its plans, and located a site. LISC provided pre-development funds and a small amount of project equity. TEDC then approached the City of Miami for a substantial grant from a special program. It also applied for long-term, low-interest loans from a mortgage program operated by Dade County. TEDC's project was the first rental project to receive a loan from this source.

The CDC then went to the Ford Foundation, the Equitable Life Assurance Society, and LISC with proposals for loans to provide the remaining financing for the project. Ford, LISC, and Equitable made commitments totaling \$2.5 million—contingent on Miami's awarding its share of the financing. Miami did so and the project was completed on schedule. It is now fully occupied.

The terms of the loan that the Foundation made to TEDC were as follows:

Term:	Nine years.
Interest rate:	3 percent.
Repayment schedule:	Thirty-year amortization schedule with the balance due at the end of nine years in a "balloon payment."
Security:	Shared first mortgage with Equitable.

Deal Points

1. The PRI was part of a larger package of equity and below-market-rate debt. As in many cases, low-cost or “no-cost” long-term financing was the key to making the housing affordable. A commercial bank provided construction financing, but low-cost PRIs were still necessary to reduce debt service over the first nine years, until cash flow from the project could support a conventional mortgage.

2. Both the Ford and Equitable commitments were made at a fairly early stage of project development, but were made *contingent* on the other pieces falling into place. In fact, the Ford and Equitable loans were the last to be disbursed, although their early commitments played a key role in leveraging the other pieces. Another key factor was the participation of a for-profit developer as a partner in the project. This developer had been introduced to TEDC by LISC and had provided technical assistance on the Edison Plaza project.

3. In reviewing this PRI, staff considered both the operating revenues available to meet debt-service payments for nine years and the project’s ability to refinance the PRI at the end of the term. Because it was necessary to keep rents low, there would be little excess debt-service coverage. To provide an additional cushion, the Foundation and Equitable required TEDC and its partner to establish a special reserve for debt service. A separate reserve was established for maintenance and capital improvements on the project. In addition, TEDC was required to contract with an experienced property management firm to manage the property.

The PRI to TEDC was a direct loan to carry out a project that represents an important step in the revitalization of the community. The PRI is being repaid on schedule, and since the completion of the project, TEDC has gone on to develop two additional housing projects in Liberty City.

LOCAL INITIATIVES SUPPORT CORPORATION (LISC)
New York, New York

1987

Amount:	\$2.5 million
Purpose:	Support of community-based development projects through LISC's local funding pools and two nationwide financing mechanisms
Source of repayment:	Recovery of interest and principal by LISC from its project loans, as well as investment income from undisbursed LISC funds

Encouraging the involvement of business, government, and philanthropic institutions in social investment has been a Foundation goal since the earliest days of PRI. The Foundation's role in establishing LISC was an essential element in this strategy. LISC offers financial and technical support to community development corporations engaged in building and rehabilitating affordable housing, and in developing commercial and industrial real estate in distressed communities. LISC provides six types of support to CDCs: loans, guarantees, grants, recoverable grants, technical assistance, and, through the National Equity Fund, equity investments. LISC emphasizes loans and guarantees—financial instruments that allow its funds to be recycled and that help build its borrowers' management skills.

LISC raises funds from a variety of donors, including national and local foundations, corporations, and financial institutions. LISC uses its funds to match local sources of support, creating locally governed funding pools, or "areas of concentration." This strategy enables LISC to leverage far greater commitments to community development than its own resources would permit. To date, LISC has generated more than \$550 million in capital from 750 local and national corporate and foundation donors, lenders, and investors. The money has been invested in over 2,100 community-based projects sponsored by 784 different community groups in twenty-seven cities.

LISC is an important success story because it has attracted new investors, become a respected policy voice, and made lending for community development credible to financial institutions. It has also persuaded many foundations to make their first PRIs.

LISC president Paul Grogan sees PRIs as a major source of

financing for LISC in the future. “Ford’s support for LISC in the early years came in the form of grants,” he says. “In 1986 there was a shift toward PRIs, initiated by LISC. It enabled a diversification of the way the Foundation supported LISC, but also demonstrated the maturation of LISC.”

In 1987 LISC approached the Foundation for PRI support to invest in the areas of concentration program pools. It also requested PRIs so that it could create two special financing mechanisms on a national basis. The first was the National Equity Fund, which was established to attract corporate investment in low-income housing, utilizing tax credits made available by the Tax Reform Act of 1986. The second was a special matching fund, which would be used by LISC to induce foundations to undertake their first PRIs for local projects.

The terms of the PRI loan that the Foundation made to LISC were as follows:

Term: (1) \$1.5 million for ten years, (2) \$500,000 for five years, and (3) \$500,000 for three years.

Interest rate: 2 percent.

Repayment schedule:

1. principal to be repaid in five equal installments over the last five years of the loan;
2. principal to be repaid in two equal installments in years four and five; and
3. principal to be repaid in one lump-sum payment at the end of the third year.

Security: None.

Deal Points

1. As an intermediary, LISC is responsible for screening, negotiating, and monitoring all the individual project loans in its portfolio. The Foundation relies on the skill and track record of the intermediary as the best protection against risk. LISC had successfully managed its loan portfolio and had a highly skilled staff and a strong technical assistance capacity that was geared specifically toward supporting community development organizations. In addition, because its early years were funded with grants, LISC

had been able to build substantial reserves as a cushion against loss. The Foundation's PRI loan to LISC has recourse to the general assets of the organization.

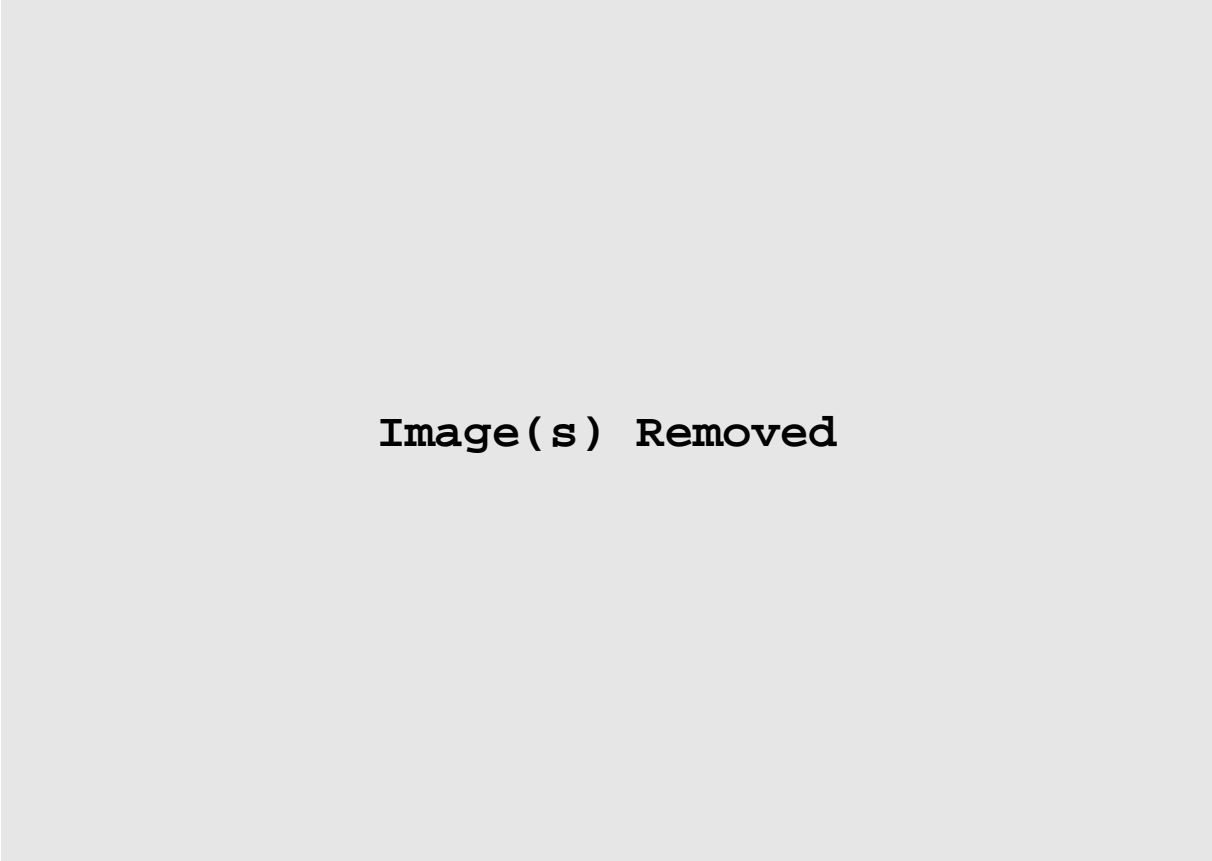
2. Different portions of the PRI loan carried different terms. As an intermediary, LISC must borrow funds that carry a term long enough to allow LISC to invest and recover the loan proceeds. To enable this to occur, more than half of the PRI carried a ten-year term. The remaining portion carried two much shorter terms, with the expectation that a combination of investment income on its reserves and refinancing from new sources would be the source of repayment.

The addition of PRIs to its funding base helped change the way LISC was perceived by new funding sources, including private capital markets. Establishing a track record of obtaining and repaying loans has helped LISC broaden its appeal to insurance companies, banks, and other corporate investors, as well as to other foundations that have not traditionally made PRIs. PRI support has also helped LISC test new programs and services, including a secondary market for loans to CDCs. "This is the completion of a process that goes from our being solely a grant program to more of a debt-financed program," says Grogan. "The Ford PRIs have set the stage for that."

As the Ford Foundation's experience with LISC indicates, a PRI loan to an intermediary can be an efficient way to channel social investment dollars to many small, community-based organizations. LISC has received several additional PRIs from the Foundation and has made all payments on schedule. LISC has used the PRI loans from the Foundation and many other sources to help revitalize hundreds of neighborhoods across the country.

GRANT-MAKING STRATEGIES AND THE PRI

These final case studies are intended to show how PRIs can be used to complement grants by enabling recipients to build long-term assets that strengthen or stabilize their operations. Each of the borrowers in the cases had been a grantee of the Foundation, and each sought PRI and grant support in order to take advantage of a special opportunity for institutional development. The first case, Neighborhood Housing Services of America (NHSA), created a secondary market mechanism in order to gain access to private capital markets and finance replication of a highly successful model program. In the second case, the organizations that became the Public Interest Law Center (PILC) had to expand their office facilities and at the same time stabilize their space costs in order to plan for future growth. Finally, Appalshop created an internally managed investment fund in order to expand its earned-income ventures and move toward reduced dependence on outside funders.



Image(s) Removed

This Cleveland neighborhood is being renovated with assistance from local banks and government working with Neighborhood Housing Services.

Image (s) Removed

Staff of the NOW Legal Defense and Education Fund, one of five groups that bought office space in the Public Interest Law Center in New York.

Image (s) Removed

Roadside Theater, the touring arm of Appalshop, a cultural cooperative, sends actors into schools like this one in Newfield, N.Y.

**NEIGHBORHOOD HOUSING SERVICES
OF AMERICA (NHS)
Oakland, California**

1978

Amount: \$200,000

Purpose: Guarantee of a loan to create a secondary market for mortgages sponsored by Neighborhood Housing Services (NHS)

Source of repayment: Debt service on loans in collateral pool

During the mid-1970s a diverse group of neighborhood organizations sought to reverse the trend of bank disinvestment in poor neighborhoods of older cities. In Pittsburgh, the Scaife Foundation helped establish a new, community-based home-mortgage lending mechanism called Neighborhood Housing Services. The idea behind NHS was to create a partnership among banks, local government, and older neighborhoods to restore public and private investment in those neighborhoods. Because it was community-based, NHS was better able to distinguish good credit risks from bad ones, encourage homeowners to rehabilitate their properties, and obtain commitments from the city government to upgrade the neighborhood's infrastructure. Depending on their credit-worthiness, homeowners could receive one of two types of mortgages: a "high-risk" mortgage from an NHS pool capitalized with philanthropic and public funds or a "bankable" mortgage provided by local banks.

The experiment worked so well that by 1978 NHS had been replicated in fifty-four cities with the assistance of Ford, local foundations, and the federal government. The NHS "high-risk" pools amounted to more than \$6 million, and bank loans to nearly \$13 million. Additional, non-NHS investment in those neighborhoods had reached \$74 million. Thus, a relatively small philanthropic commitment was able to leverage many times the amount of the commitment in public and private funds. As the NHS organizations matured, however, the limited resources of many of the "high-risk" pools were used up and new "high-risk" loans could not be made. Faced with the need for additional liquidity in order to grow, the umbrella organization for the NHS network, Neighborhood Housing Services of America, recognized the need to package and sell NHS loans to private capital markets. To test whether a sec-

ondary market for NHS loans could be established, NHSA approached the Equitable Life Assurance Society and the Ford Foundation to support a pilot transaction. Equitable agreed to lend \$1 million to NHSA to be collateralized with NHS mortgages from the pools. But, given the high-risk nature of the collateral, Equitable asked for a portion of its loan to be guaranteed. The Foundation agreed to provide a 20 percent, or \$200,000, guarantee to Equitable.

The terms of the guarantee to Equitable were as follows:

- Term:** Ten years.
- Fee:** None.
- Security:** NHSA would identify \$1.25 million in sound NHS loans to collateralize and service Equitable’s \$1 million, ten-year, 8.5 percent loan to NHSA. If any loan in the “bundle” went bad, it would be replaced with another loan that was repaying on schedule.

In addition, NHSA would set up a \$200,000 reserve for debt service, to be established by grants from the Ford Foundation and other sources.

Conditions to payout of Ford guarantee:

The Foundation’s guarantee could be called only in the event that Equitable’s losses exceeded the capacity of the collateral pool and the reserve to service the debt.

Deal Points

1. Because the objective of the NHTSA PRI was to induce a conventional, private lender to invest in NHTSA, it made sense to use the PRI mechanism as a guarantee rather than as a direct loan to the NHTSA pool. Equitable's concern was that the NHTSA loans, which had a 25 percent delinquency rate at that time, were not of sufficient quality to service the Equitable debt. The Foundation, however, had worked with the NHTSA network for many years and knew from experience that, while many NHTSA loans were repaid slowly, more than 90 percent were likely to be fully repaid ultimately.

Although a guarantee was appropriate for this PRI, it was in some ways a riskier form of PRI because there would be little likelihood of repayment should it be called. On the other hand, the guarantee funds remained within the Foundation's corpus and earned interest for the Foundation during the entire program period. And because the Foundation's grant program was familiar with the types of loans that NHTSA made, the level of risk of default did not seem as high to the Foundation as might be perceived by outside lenders.

2. The Foundation combined the PRI with a \$100,000 grant for a debt-service reserve fund. Staff considered a loan or recoverable grant for this purpose, but reasoned that the grant could help capitalize a permanent base for future secondary market transactions.

The Foundation's guarantee was never called, and NHTSA's initial experience with the Equitable investment was so successful that it was able to negotiate additional investments without guarantees. By 1987 NHTSA was providing liquidity to 241 neighborhood programs with loan funds totaling \$150 million.

The "pilot" transaction with Equitable created a new window for NHTSA capitalization at a critical stage in its development. The PRI guarantee was used to complement an already successful grant-making strategy in order to dramatically expand the NHTSA network.

PUBLIC INTEREST LAW CENTER (PILC)

New York, New York

1983

Amount: \$670,565

Purpose: To enable five public interest law groups to renovate, lease, and then purchase office space together

Source of repayment: Commercial refinancing and fund raising

The Public Interest Law Center had its genesis in the difficulty of finding affordable office space in crowded New York City. In 1982 the Ford Foundation received a request for loan and grant funds from eleven New York-based public interest law firms interested in leasing and eventually purchasing space together. "We were priced out of the midtown market," recalls Colleen Myers, then director of the Council of New York Law Associates. Working with staff of the Foundation's then Human Rights and Governance program, the PRI division gave the group a planning grant to help them assess their real estate opportunities.

The planning grant resulted in an agreement by five of the groups to enter into a lease with an option to purchase space in a building in the Tribeca area of Manhattan. The groups were the NAACP Legal Defense and Educational Fund, the Council of New York Law Associates, the Asian American Legal Defense and Education Fund, the National Organization for Women's Legal Defense and Education Fund, and the Puerto Rican Legal Defense and Education Fund.

Although all the organizations had existed for many years and their option to purchase was a valuable asset, banks were reluctant to lend money to organizations that depend on the vicissitudes of annual fund raising. The Foundation, however, as a long-time supporter of most of the organizations, had confidence in their ability to meet their obligations.

The Foundation awarded \$398,969 in grant funds and \$670,565 in loans to the law firms to pay for moving costs and rehabilitation of the new space. Each group had its own lease with an option to buy at the end of six years. A condition of the loan agreement was that the groups form an entity called the Public Interest Law Center to carry out joint program activities and to administer a sinking fund for capital raised to purchase the space and repay their PRI loans.

“The PRI enabled us to acquire a space we could afford and allowed us to stay in the city,” says Julius Chambers, director of the NAACP Legal Defense and Educational Fund, which has since been the first of the five groups to purchase its space.

The program benefits of this joint venture have exceeded all expectations. “We could not have envisioned the kind of collaboration that has resulted from sharing space,” Chambers adds. The groups share conference space, equipment, and use of the NAACP Legal Defense and Educational Fund Library. They also share litigation strategy and have developed joint programs for summer interns. “We get a better idea of what public interest law is about by seeing five organizations at work,” says Chambers.

For example, when the Asian American Legal Defense and Education Fund had a case in Chinatown involving housing displacement, the Council of New York Law Associates, which specializes in community development, prepared an amicus brief identifying alternatives to the displacement. “That opportunity would not have been so readily identified if we hadn’t been in the building together,” says Myers.

The terms of PRI loans made to the five groups were as follows:

Term:	Up to seven years.
Interest rate:	5 percent.
Repayment schedule:	Level payments based on a fifteen-year amortization schedule with a “balloon” payment in the seventh year.
Security:	Assignment of the leasehold mortgages and the condominium purchase options.

Deal Points

1. The principal risks of this PRI were: that the groups would not be able to handle the initially higher costs of their space, that fund raising would be insufficient to exercise the purchase options, and that the groups would be unable to pay off the “balloon” at the end of the PRI term. The planning process itself, which had been supported by a planning grant from the Foundation, enabled the law groups to look critically at their space needs and at what

they could afford based on past and projected fund-raising ability. The analysis included comparing the projected costs of the new rents and debt service to each organization's current space costs. This enabled each group to see exactly what the marginal increases would be. Interestingly, the planning process also helped the groups that ultimately dropped out to better understand their space needs and priorities.

2. An analysis of a commercial refinancing scenario indicated that annual debt service on a loan large enough to repay all of the PRI plus the condominium purchase price would not be greater than the rent burden the groups were carrying at the time the PRI was made.

3. The PRI was structured to include a provision for a mandatory sinking fund administered jointly by the five groups. This sinking fund had two purposes: to encourage the groups to begin raising funds well in advance of when their purchase options could be exercised, and to create an interest-earning asset that could help cushion the initial impact of the higher rents and debt service on the PRI. An additional "cushion" was provided by the combination of grant and PRI funding in the project, whereby more than one-third of the costs were supported by grant funds.

Although fund raising took longer than expected, all five groups ultimately purchased their space. One-half of the Ford PRI was repaid through the capital campaign, and the remaining loan was extended in conjunction with additional financing from the New York Job Development Authority.

This project represented a one-time opportunity to stabilize the operations of a cluster of grantees by helping them acquire long-term assets. The PRI tool was useful in complementing an existing grant-making area and provided some unexpected program benefits as well.

APPALSHOP
Whitesburg, Kentucky

1988

Amount: \$400,000

Purpose: Establishment of an investment fund to be used by Appalshop to underwrite its own income-generating projects

Source of repayment: Revenues generated by projects and interest earnings on the fund itself

When Herb E. Smith was seventeen years old, a man arrived in his tiny Kentucky town with some government film equipment to offer a workshop. "It was like a spaceship had flown in," Smith recalls. "We learned how to use the equipment by making films. You get to know a place better by filming it. We got to thinking about this place, and knowing it. Examining it. And then we started to ask, 'Why are things this way?'"

More than twenty years later, Smith still lives in his Appalachian home town and, remarkably, he makes his living through film. Several of the participants in that first film workshop decided that, as Smith puts it, "We were going to stay right here and make jobs for ourselves." What they made turned into Appalshop, an organization with the goal of preserving Appalachia's rich cultural heritage.

Appalshop produces films, videos, and recordings released through its label, June Apple Records. Its Roadside Theater tours the United States with productions based on oral histories of local residents. And it is the licensee of a noncommercial radio station that Smith calls "a steady, daily presence in people's lives here."

From its earliest days, Appalshop, which is run as a collective, has been involved in revenue-generating activities. Film, record, and ticket sales currently account for about 30 percent of its income. "We have been trying to increase this," says Smith, "to try to build a solid base for Appalshop."

Having previously received Ford Foundation grant support, Appalshop approached the Foundation in 1988 seeking funds to expand its revenue-generating activities. A PRI of \$400,000 created a fund to be used for equipment purchases, distribution costs, and other expenses for projects that have the potential to develop a predictable income stream. A grant of \$50,000 was awarded along with the PRI to serve as a loss reserve fund.

“This has given us some venture capital that we can use to take advantage of opportunities as they arise,” says Smith. “Even though we receive grants for specific programs, like Roadside Theater, it’s unlikely we could get a grant for this kind of investment fund. It allows us to concentrate—with some assets behind us—on how we can be more viable through earned income.

“Earned income is important to us in so many ways. When someone buys from us, they’re paying for a good or service, so it’s a way of ensuring that our films and videos are seen. You maintain a relationship with the users—and their money comes in with no strings attached.”

Smith hopes the projects funded through the PRI will ultimately generate more jobs within the organization. Appalshop is already a major employer in Whitesburg. As Smith says, “In a town of 1,500, thirty-two jobs count.”

Even more important than the number of jobs it provides is the sense of hope and pride it has given residents, for whom positive cultural identity is a scarce resource. In a region where 30 percent unemployment is normal, “the people aren’t true participants in the economy,” Smith says. “When I was growing up, if the coal companies didn’t come in and provide you with work, you had to leave town. There hasn’t been a tradition here of people creating jobs for themselves, and that’s what we want to do.”

The terms of the loan the Foundation made to Appalshop were as follows:

Term:	Six years.
Interest rate:	1 percent.
Repayment schedule:	Interest only for four years, \$100,000 due at the end of year five, and \$300,000 at the end of year six.
Security:	None.

Deal Points

1. Like the loan to Research Libraries Group, the PRI loan to Appalshop is inherently risky because repayment depends on investments in ventures. In reviewing this loan, PRI staff were concerned with how Appalshop would go about making its investment decisions, and worked with Appalshop to develop procedures to ensure that each investment would be considered carefully. The pool of funds is administered as an internal loan fund, with each project presented to an internal loan committee by the project director. Each project will return a portion of its revenues to the pool, and projections will be compared to actual performance on a monthly basis.

2. Although the fund is administered internally by Appalshop, the terms of the PRI also required that each “deal” be reviewed by two independent advisers who were local economic development practitioners. The advisers would be asked to offer comments and suggestions before the projects were approved by the loan committee. The involvement of these outside experts was seen as providing benefits to Appalshop beyond the ventures themselves, by encouraging it to reach out to resources beyond its immediate community.

3. To offset some of the risks of the PRI, a grant of \$50,000 was made to Appalshop to create a loss reserve. The interest earnings on the loss reserve and the fund will create an additional cushion that, when added to the loss reserve, will allow for a 25 percent loss in the investment fund. This structure recognized that an investment in ventures is inherently risky and should be funded with equity as well as debt.

The PRI loan enabled Appalshop to create a unique asset—an internal investment fund—that permits the organization to take advantage of earned-income opportunities. Such opportunities are important because they represent both institutional growth for Appalshop and potential new jobs in the community.

WHY PROGRAM-RELATED INVESTMENTS?

Are there particular benefits to using PRIs as a philanthropic tool? All the projects profiled here could have achieved their goals with grants, although the amount required by some would have strained the resources of even the largest foundation. Nevertheless, Ford Foundation staff and trustees believe that the availability of PRIs as well as grants enhances Foundation effectiveness.

The Studio Museum in Harlem provides a case in point. The PRI to the Studio Museum would have been considered too risky under normal investment terms. Because of the size of the project and the Foundation's reluctance to make capital gifts, it would probably not have been done as a grant, either. But in the process of negotiating a loan, the Foundation observed the tenacity and talent of the museum's leadership as well as the importance of its programs. These factors were added to an investment analysis that concluded the project could work. The result was that the Foundation took the risk, and this particular investment paid off.

Specific benefits of using PRIs include:

Capacity-building for individuals and institutions. The form of a PRI—getting and repaying funds under disciplined terms—is particularly appropriate for nonprofit organizations and community development projects, which place great emphasis on self-help and self-sufficiency. A Foundation grants officer says, “People learning how to manage and pay back is a social return. You get a different quality of experience paying back a loan than you do from managing a grant.” Successfully managing a loan provides a nonprofit group another set of experiences, adding to its skills and record.

The development of skills, attitudes, and management disciplines needed in revenue-producing enterprises can be particularly important for groups engaged in community development. Says one PRI recipient: “Developing a business plan helped us change our thinking about our organization—from social service provider to self-sufficient economic development entity.”

Enabling nonprofit organizations to build long-term assets. PRIs offer foundations a tool that can stretch their assets. Because PRIs can be recycled, they enable foundations to take advantage of special opportunities to create considerable assets for grantees, without compromising the foundation's grant-making resources. According to Martha Lewin of the Jersey City YWCA, their PRI enabled the Y to "take a structure that was a financial burden and turn it into an asset that ensures we will have funds for operating support."

Obtaining project or venture financing. By taking a subordinate position, PRIs can transform projects into feasible investments for conventional lenders. National intermediaries like the Local Initiatives Support Corporation have helped attract many new funding sources to the community development field. "PRI support definitely helped us convince private lenders to get involved," says one intermediary that received a PRI. "The PRI made community development seem safer for them. And the loans we've made with the money have reached people who had been completely locked out of the credit market."

The PRI mechanism can also benefit a foundation by allowing for the recovery and recycling of its resources. In addition, PRIs offer foundations another way of working with grantees. PRIs often involve a longer-term relationship than a typical grant does, as well as the closer, more complex ties of an investment relationship. Also, an investment creates incentives to stay in touch with a project and offer advice and other assistance if it encounters setbacks.

Asked to reflect on the PRIs they have made, Foundation staff frequently note that PRIs are a hybrid of investment and grant, and that the review of a potential PRI is a collaborative effort involving the financial and programmatic skills of both PRI staff and their grant-making colleagues. Often, the process of determining whether a loan can be repaid helps staff conclude that a grant might be more suitable than a PRI. Making loans where no clear source of repayment exists does not make good business or philanthropic sense. Very risky ventures may best be launched with grant support as seed money. Sometimes the strain of starting a revenue-generating venture can deflect an undercapitalized nonprofit agency from its main purpose and programs.

PRIs, then, are not a substitute for grants. Rather, they are an extension of philanthropic work, an enrichment of the resources available. Used skillfully, they can expand the range and impact of a foundation's work and deepen its relationship with recipients.

APPENDIX

FIVE-YEAR FINANCIAL SUMMARY

The following table presents PRI financial data for fiscal years 1987 through 1991 (dollars are in thousands):

SOURCE	1987	1988	1989	1990	1991
Investments, guarantees, and unfunded commitments outstanding, year-end	\$77,799	\$84,052	\$92,715	\$98,999	\$108,187
New PRI commitments	\$15,184	\$13,150	\$16,500	\$14,859	\$15,150
Equity grants	\$616	\$500	\$400	\$750	\$675
Principal recovered	\$3,694	\$3,647	\$5,957	\$7,270	\$4,982
PRIs written off	\$3,170	0	\$1,880	\$757	\$973
Earnings received	\$1,175	\$1,156	\$1,397	\$1,298	\$1,329
Number of PRIs in the portfolio, year-end	111	119	128	124	125
Number of PRI program officers	5	6	6	5	5

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