April 2024

Private Foundations Bulletin

The Benefits and Challenges of Program-Related Investments

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Private foundations, known for distributing grants to serve the public good, may utilize other alternatives to advance their charitable purpose, meet distribution requirements and potentially realize a financial return. Program-Related Investments (PRIs) are one such alternative.

PRIs are extremely versatile and can be structured in many alternative forms of financing (i.e., unsecured loans, guarantees, bonds, mortgages, etc.), equity investments (private equity), etc. PRIs can be made to any type of recipient (i.e., nonprofits, for-profit social enterprises, government, individuals, etc.), where that recipient gains access to capital at lower rates or cost potentially at an amount greater than a typical grant. A nominal return of equity or repayment of capital can be expected by the foundation, and any financial returns from a PRI can then be reinvested or granted for new charitable purposes.

As defined by the Internal Revenue Service (IRS), PRIs are those in which:

1. The primary purpose is to accomplish one or more of the foundation's exempt purposes,
2. Production of income or appreciation of property is not a significant purpose, and
3. Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose.

Examples of PRIs

According to the IRS, below are a few typical examples of program-related investments:

- Low-interest or interest-free loans to needy students,
- High-risk investments in nonprofit low-income housing projects,
- Low-interest loans to small businesses owned by members of economically disadvantaged groups, where commercial funds at reasonable interest rates are not readily available,
- Investments in businesses in low-income areas (both domestic and foreign) under a plan to improve the economy of the area by providing employment or training for unemployed residents, and
- Investments in nonprofit organizations combating community deterioration.

The Benefits and Challenges of PRIs

Program-related investments present both benefits as well as many challenges, such as:

Benefits

- PRIs help obtain a larger impact and alignment with their core values by investing in projects or initiatives specifically related to their goals and mission.
- PRIs allow foundations to maintain their endowment while producing investment returns and reinvest those returns into future charitable endeavors.

- PRIs present an opportunity for foundations to support innovative solutions to social issues. Foundations are able to invest in early-stage projects, which greatly contributes to the nonprofit and social enterprise sectors.
- PRIs allow foundations more flexibility to take higher risks by supporting projects and organizations that may have a more difficult time attracting traditional investment capital due to identified risks or failures in the market.

Challenges

- Just as PRIs offer the possibility of investment returns, financial losses are also feasible when the investment is impacted by market uncertainties, operational challenges or unforeseen setbacks.
- The structure and organization of PRIs require specialized knowledge in both finance and philanthropy. Foundations are required to navigate intricate legal and regulatory frameworks, effectively monitor performance and assess investment opportunities.
- PRIs, in comparison to grants, generally have extended investment horizons and may be illiquid for longer periods of time. Foundations are required to precisely consider their liquidity demands in order to sustain adequate funds for continuous grantmaking and operational expenditures.

In the past, many foundations have shied away from PRIs because either they seem too complex or they are unfamiliar with the tax reporting requirements. The popularity of PRIs, however, is on the rise within the foundation community. They can help the foundation develop financial discipline and planning skills, as well as provide the opportunity to leverage philanthropic dollars for greater social impact. While PRIs need not be the sole strategy – when used to complement effective grantmaking – a foundation may be able to advance its charitable purpose more efficiently and have a long-term impact.

Tax Considerations

Listed below are some of the considerations regarding PRIs that should be taken into account:

- When expended, the amount is deemed to be a qualifying distribution when a foundation enters in a PRI. In the year the PRI is repaid to the foundation, the repayment is calculated as a reduction of the foundation’s qualified distributions. To ensure that the foundation remains in compliance with minimum distribution requirements, the timing of when PRIs are expended and repaid should, in fact, be monitored.
- Generally, PRIs require a higher level of due diligence in comparison to a simple grantmaking program. Some PRIs also require the exercise of expenditure responsibility (i.e., PRIs that are commercial ventures).
- PRIs require additional disclosure on the Form 990-PF.
- Due to being considered a charitable-use asset, PRIs are not included in the mandatory distribution calculation.
- As part of its charitable purpose, PRIs cannot be used to fund political activities or influence legislation.
- PRIs are exempt from the excess business holding tax. Excess business holding tax is typically imposed for investments that comprise more than 20 percent interest in for-profit ventures, as well as the investment tax, which is generally imposed for investments that financially endanger the charitable work of the foundation.
- Income that is generated from PRIs is also not subject to unrelated business income tax (UBIT) as it directly furthers the foundation’s exempt purpose(s).

Conclusion

Not all foundations may find PRIs an ideal method for financing. However, PRIs may be worth considering when furthering a foundation’s purpose and mission.

Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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