

the magic roundabout

How charities can make their money
go further

An introductory guide to
Programme Related Investment

'The voluntary sector makes a vital and undeniably valuable contribution to society and research consistently highlights the need to develop strategies that achieve a sustainable funding environment for these organisations'
Rt Hon Paul Boateng MP, November 2000

Charity funding is under great pressure.

This short guide introduces and illustrates a technique already adopted with considerable success by a small number of charities.

The technique is called Programme Related Investment.

And it can help your organisation make charitable resources go further...

Acknowledgements

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Introduction

This short booklet explains how charities can make their money go further.

It is called the Magic Roundabout because it explores how charitable funds can be creatively recycled.

Specifically it sets out how charitable investments *and* grants budgets can be made to work harder, and smarter, using a technique called Programme Related Investment - or PRI.

Programme Related Investment

Programme Related Investments combine financial *and* social objectives.

Conventional charity investments are obliged to maximise financial return. Whilst generating income for the investing charity, funds are not put *directly* to work in the social sector. Returns are used for charitable purposes - but assets are not. And the value of our assets far outstrips the value of the income that they generate.

Is there a way to make charitable assets sweat harder? Yes.

A Programme Related Investment is not the same as a traditional financial investment. Programme Related Investments enable charities to achieve a 'double bottom line'. When charities invest in initiatives that advance their own charitable objectives, the investment is said to be 'programme related' and the investing charity need not comply with the usual obligation to maximise only financial return. Programme Related Investments therefore enable charities to work their assets harder by investing charitable funds *directly* in charitable activity, making a social as well as a financial return on the investment.

By definition, a grant can only be spent once.

Is there a way to spend our money many times? Yes.

Using PRI, grant-making charities can, when appropriate, make returnable loans as well as grants, recycling charitable funds many times over.

Put simply, as the Charity Commission has made clear, (and as some charities have already discovered), PRI is an effective way of making charitable funds go further by

- Investing a portion of charitable assets in charities that share the investor's own charitable purposes – putting charitable investments to work *directly* for charitable aims
- Restructuring a portion of grants budgets so that loans are made in place of grants – spending money more than once

As we shall see, Programme Related Investments can be made in charitable organisations in a number of ways - benefiting investor and investee alike. This guide has been written with large operating charities specifically in mind. Yet the principles that it introduces can be used by almost all sizes of operating charity, and by grant making trusts and foundations.

PRI is not a cure for all ills. Neither should this guide's promotion of PRI be seen to undermine conventional investment and grant making practices. PRI simply enables charities to restructure *a sensible portion* of investments and grants budgets - and in so doing extract greater value from scarce charitable resources. PRI is an additional tool in the box. And in a troubled time for charity funding we need to exploit every opportunity available.

The Magic Roundabout

The Magic Roundabout is a guide of two halves.

The first half introduces PRI and demonstrates need, opportunity and potential.

The second half unpicks the practicalities, examining the legal, administrative and accounting implications of making Programme Related Investments.

Its aim is simple: to raise awareness, to engage and enthuse – to stimulate serious, sustained and strategic discussion about the potential of PRI.

It draws on pioneering examples spelling out real-life tales of success. These examples illustrate how, for the investor, PRI is a means of making investments work harder; and how, for the investee, Programme Related Investments give access to finance that would otherwise be denied. Can these isolated examples show the way to greater things? Can we as a sector collectively begin to change the way we are funded, build our capacity, and creatively recycle our money?

For the Magic Roundabout follows no organisational 'agenda'. It has been written by, with and for charity practitioners - by individuals well versed in charity finance, who are pragmatic and passionate about the change-making potential of PRI - and who hope that at the end of your ride on the Magic Roundabout, you will be too.

The Challenge



Q. What is the value of PRI?

A. PRI can sustain beneficiary benefits beyond the limits of 'charity'

Charity funding is in trouble

Faced with a falling stock market, declining lottery ticket sales and limited growth in levels of individual giving, continuingly low levels of financial support from private business and the prospect of the European Structural Funds being spent entirely in new-member states from 2006, it is imperative that charities are provided with the means of diversifying their revenue base and developing new income streams.

Many operating charities (and charitable foundations) have traditionally placed a heavy reliance on 'cap in hand' fundraising or grants (from statutory sources, the lottery, trusts and foundations) to provide a financial base for their activities. Whilst possibly successful in securing the charity's immediate operational viability, in the longer term this has often led to situations where charities have become heavily dependent on one source of income. In older charities this source has often been legacies.

In addition to immediate financial concerns arising from relying on one particular revenue source, such reliance can equally produce an organisational culture of dependency, a culture that is increasingly ill-suited to the competitive world in which charities now have to operate.

If we are to sustain the good that we do, we need innovative, new and complementary techniques to secure future funding. There will, of course, always be a place for traditional philanthropy and project-focused grants. This guide is not critical of what has been termed 'the gift economy' – it simply argues that 'charity' alone will no longer suffice. We all well know that where possible charities must generate new revenue-streams and work existing funds as efficiently as possible at every available opportunity.

In short we can no longer rely solely upon the kindness of strangers: we need to start doing it for ourselves. What's more: we can....

New opportunities are emerging

There is an increasing interest, within government and civil society, in 'social enterprise' – trading for a social purpose. Social enterprise raises awareness of a wide variety of alternative economic techniques, harnessing market forces to social goals.

For charities, social enterprise is a means of developing unrestricted income from trading activity – not just along the traditional line of 'charity shops' but equally from mission-related trading. Many examples show that self-financing can be *one* alternative to the flaws of the current funding paradigm in which voluntary organisations compete for a limited pie of existing charitable resources and subsist on a staple diet of short-term, project-based grants.

Though not all charities will be able to develop trading income and whilst this guide implies no criticism of traditional fundraising activities, three short case-studies remind us that an increasing number of charities are diversifying away from an exclusive reliance on charitable donations and time-limited grants.

The voluntary sector is becoming more enterprising, generating new sources of income from trading mission-related goods and services...

Speaking Up! is a Cambridge-based charity working with adults with learning difficulties – they generate more than 25% of annual turnover from training and consultancy traded to other social care providers wanting to learn about the development of self-advocacy programmes. And because that training is delivered by Speaking Up!'s own client group, the business not only makes money, it also furthers the charity's mission: what better way to self-advocate than train others about self-advocacy – whilst simultaneously spreading good practice.

In a very different setting, Community Action Furness runs a youth project refurbishing mountain bikes – and generates critical income after spotting that if you put the two key assets together (bikes and young people) you can develop yourself a profit-making mail delivery service!

An East London neighbourhood initiative generates considerable revenue from selling a training package developed from its own volunteer training programme to a private company. The community project draws on the work of dozens of volunteers and in building up voluntary action has accumulated a great deal of know-how on training and motivation. A private company values that intellectual property highly.

These are just 3 of many examples of ways in which voluntary and community organisations are generating unrestricted income from mission-related trading activity.

The charity and voluntary sector is set to play an increasing role in the delivery of public services – as recognised in the Treasury Review of the Voluntary Sector (November 2002) and subsequent decisions to invest in infrastructure and capacity building.

In summary, as charities embrace entrepreneurship, enter into contracts and become more far-reaching in their scope, they require access to a full set of financial services to ease cashflow and provide working and even risk capital for the development of new initiatives. Loans, guarantees, even forms of equity investment can be required – not to supplant grants and charitable donations but to work alongside conventional forms of charity finance.

Yet opportunities can be lost for lack of available finance

Whilst the conventional banking system has shown itself able and inclined to bank some charitable activity, commercial finance providers are sometimes either unwilling or unable to meet the needs of initiatives that lie beyond the profit margins, risk and cultural understanding of the for-profit financial services market. Thus an ambitious voluntary organisation, whilst every bit as professional as a private business, can find itself denied access to a comparable options in terms of financing.

In short, there is a gap in the finance market: and this gap can be an inhibitor to growth. Loan finance can play a critical role in sustaining social change. Individual charities can find themselves able to raise charitable grants and voluntary donations, but unable to raise the finance necessary to secure growth and development at critical stages of the organisational lifecycle. Charities can find themselves ‘fundable but not bankable.’

Evidence of both the current lack, and necessity, of access to finance is set out clearly in the Social Investment Task Force Report - whose recommendations inspired this guide. The existence of a finance gap (and the pressing need to plug it) has, equally, been made explicit in the DTI’s commissioning, in July 2002, of the Bank of England to undertake a review of access for third sector organisations to commercial finance.

The case of Baby Lifeline sets the problem in sharp relief.

'Of course midwives and doctors ought to be trained already to cope with anything – but you can never have all the facts, you can never have enough training.' A recent government report into avoidable deaths and injuries at birth revealed an unacceptably high number of misdiagnosis and error, which could be greatly reduced by better training for medical and midwifery professionals.

Judy Ledger lost three premature babies herself before setting up Baby Lifeline, a national registered charity providing 'support for the care of pregnancy and birth.' Since 1981 Baby Lifeline has raised more than £4million to fund equipment such as scanners and heart monitors as well as training events and materials.

Baby Lifeline's latest project has been the production of 9 training videos in a series entitled B.I.R.T.H. (Bringing Interactive Response Training to Hospitals), detailing 'some of the things that commonly go wrong in childbirth and the ways to tackle them.'

The charity was unable to fundraise for the full amount. Knowing that the videos would be purchased by medical professionals, Judy Ledger approached the banks for loan finance.

'But the banks didn't want to know – it's very difficult to explain your problems to an ordinary business world.' So Judy approached Charity Bank. 'Charity Bank was willing to listen. It's very difficult for charities to get that sort of support – they understood the sort of charity we are.'

Charity Bank made a £40,000 three-year secured loan to cover final production costs. 'We couldn't have got there without this loan finance,' Judy continues. 'And the completed video series has given us a massive platform with the professionals – including bodies which originally refused to have anything to do with the project, still less fund it.'

With their increased profile, Baby Lifeline have launched a national fundraising campaign. They approached Charity Bank for working capital to fund this. 'With their increased profile however,' explains Malcolm Hayday, Chief Executive of Charity Bank, 'we felt that the commercial banks could fund this – and they have. So in addition to facilitating the video production, loan finance has also effectively leveraged commercial finance where before it was lacking. For a £40,000 returnable spend it's hard to think of a more efficient way of adding charitable value!'

This case study is taken from 'Community Development Finance Institutions: a new financial instrument for social, economic and physical renewal' written by Radhika Holstrom and published by the UK Social Investment Forum. The authors of the Magic Roundabout are grateful for permission to reproduce it here.

Charitable funds can help to close the gap

The case of Charity Bank and Baby Lifeline illustrates the point well: charities may be in need of loan finance, but they cannot necessarily access it from the commercial banking sector.

Yet if Baby Lifeline illustrates the problem, they equally showcase an answer. Expert intermediary institutions like Charity Bank and others can help bridge the finance gap.

Charity Bank is an example of a Community Development Finance Institution (CDFI). CDFIs provide financial services, and in some instances business support, to individuals and organisations that are unable to access these services from commercial financial services providers. CDFIs work in disadvantaged communities and under-served markets, including the voluntary sector.

CDFIs can themselves be capitalised by charitable funds invested as PRI. As we shall see, PRI can be made *either* via Community Development Finance Institutions, *or* directly through a charity.

Whichever way PRI is made, the key point is that the investment makes a financial return for the investor *at the same time* as facilitating growth in other charitable organisations. PRI can therefore play a crucial part in increasing *total* charitable resources. PRI is a way of investing in one another – not competing for slices of a limited pie, but building our collective wealth.

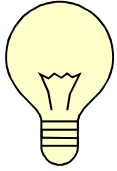
We will visit further homegrown examples demonstrating the positive impact that PRI can have on both investor and investee alike.

Looking across the Atlantic provides further clues as to the power of PRI. The North Americans have developed the concept of a 'non-profit capital market' operating beyond the commercial finance industry to support social purpose initiatives.

In the US as elsewhere, the demands on philanthropy have always exceeded its resources. Staff at the Ford Foundation stressed this point when recommending PRI to trustees in 1968, explaining, 'The foundation does not have nearly enough cash to meet all the demands on its agenda, so PRI should be a way to stretch limited funds, as well as to attract the funds of others to good projects.' From an initial \$10 million, PRI has grown, with around \$500 million outstanding at any time. Today, foundations, large and small – private, family, community and corporate make PRIs in support of a wide variety of social purpose projects, either direct or via intermediaries, creating a social capital market alongside grant streams. As they experiment, many find these tools cause them to think differently about philanthropy; about capacity building within the investor as well as the recipient; about leverage and building long-term assets. Although, PRI in the USA is dominated by a few major funders it has undoubtedly added new resources to the financing of charity.

As we shall see in the following section, over the past two years, a series of highly practical UK developments has begun to establish a similar, if embryonic, non-profit financial services market. Programme Related Investments can help to capitalise and

expand this market. For the prize is great – nothing less than a new, *mission-driven* financial services sector, sustaining social action beyond the limits of both traditional charity and conventional finance.



Summary of this section's key points

- To sustain benefits to beneficiaries, charities are developing essential new income streams from enterprising forms of trading activity. Charities are also undertaking a greater role in public service delivery and developing the scope and range of their work.
- As a charity grows it requires access to the full range of finance for its activities.
- The conventional banking industry is not always willing to provide finance to charitable organisations. Charities can find themselves fundable but not bankable.
- Lack of appropriate finance inhibits growth and sustainability
- Large charities can invest charitable funds in other charities to help 'plug the gap'.
- Such investments make a financial return for the investor charity –*at the same time* as using charitable funds to support charitable activity directly.
- PRI makes charitable funds sweat harder.



Looking forwards

- The potential of PRI is not theoretical.
- New opportunities are fast emerging...

The opportunity - emerging forms of finance



Q. Is there a wider picture here?

A. Yes, and sketching the picture helps us to fully understand the power and application of PRI.

PRI in context

Definitions are not the purpose of this guide. Yet as the Magic Roundabout aims to raise awareness and stimulate debate, and in order to fully understand emerging opportunities, some background information is required.

PRI is a form of Social Investment and the particular form of Social Investment open to charities. Social Investment is itself a form of Socially Responsible Investment (SRI). Picture a set of Russian dolls: PRI is contained within Social Investment contained within SRI. Acquaintance with the set aids understanding of the specific.

So in order of size, largest doll first...

1. **Socially Responsible Investment** (used interchangeably with Ethical Investment and to which usual investment rules apply) is an overarching term that refers to investments that combine investors' financial objectives with their commitment to social concerns such as social justice, economic development, or a healthy environment. SRI describes investment that takes account of the investors' values and objectives, whether social or environmental, whilst also delivering a financial return.

2. **Social Investment** can be thought of as a *particular form* of SRI because it is investment that is targeted to serve under-invested markets (of geography or interest) through non-conventional financial vehicles called Community Development Finance Institutions (CDFIs) as opposed to conventional investment vehicles such as ethical ISAs, pension funds etc.

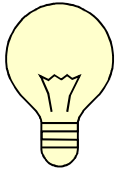
Social Investment can be applied in a variety of ways including debt finance, loan guarantees, micro credit schemes (as pioneered in south Asia through the renowned Grameen Bank for example) and (though less commonly) equity investment and for-profit 'social venture capital funds'.

Whatever the form of Social Investment, certain themes prevail:

- Resources are used to achieve a desired social outcome as well as a financial return
- The financial return is usually (though not always) smaller than traditional forms of investment

- Money is invested rather than given: demonstrable social returns are certainly expected to offset any financial sacrifice
- Social investment is targeted at building capacity and independence
- The intention is to recycle the investment – enabling funds to be used to promote social change over and over – as opposed to a one-use-only grant

3. **Programme Related Investment** is itself a form of Social Investment because, in investing in charitable objects, it serves an under-invested market.



To recap, PRI enables charities to:

1. Invest charitable assets in charitable activities that share their own charitable purposes. So long as the investment advances the investor's charitable purposes, usual investment rules insisting on maximum financial return do not apply.
2. Restructure a portion of their grants budget as loans - enabling charitable funds to be used more than once.

PRI and public policy



Q. Why now?

A. We live in exciting times.

Opportunities for PRI that only a year ago may have been derided or disbelieved are opening up.

In 2000, the Chancellor of the Exchequer set up a task force on Social Investment, which combined expertise from the private and voluntary sectors to look at how the Government and the voluntary and private sectors could stimulate Social Investment (i.e. investment into under-invested neighbourhoods and under-served markets.)

The report made five recommendations: -

1. A Community Investment Tax Credit (CITC) - to encourage private investment in under-invested communities, via Community Development Financial Institutions (CDFI's) that can invest in both not-for-profit and profit seeking enterprises.
2. Support for Community Development Financial Institutions.
3. A Community Development Venture Fund – a matched funding partnership between Government on the one hand and the venture capital industry, entrepreneurs, institutional investors and banks on the other.
4. Disclosure by banks of their lending record to under-invested neighbourhoods.

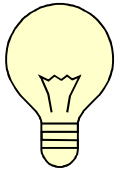
And

5. Greater latitude and encouragement for charitable trusts and foundations to invest in community development initiatives.

All 5 recommendations were welcomed by the Chancellor in his November 2000 pre-budget announcement. (You can find out more about the Report's recommendations via the final section 'Useful Contacts').

Recommendation 5 was immediately supported by new Charity Commission guidance on the use of charity funds for the purpose of PRI. The Charity Commission's guidance confirmed that PRI is an acceptable way for a charity to pursue its charitable purposes. (The legal position on PRI is set out in greater detail in the second half of the Magic Roundabout.)

Meanwhile, from a practical, administrative perspective the emergence of Community Development Finance Institutions makes Programme Related Investments relatively simple to administer. As will be evidenced by case-studies, CDFIs are effective mediums through which charities can make Programme Related Investments.



Summary of this section's key points

- Programme Related Investment is a particular form of Social Investment
- Social Investments combine financial and social returns
- Programme Related Investment is the form of Social Investment open to charitable organisations
- Significant developments in public policy have clarified that Programme Related Investments are a proper form of investment for registered charities to undertake
- The rise of a new breed of not-for-profit financial service provider, the 'Community Development Finance Institution' makes it relatively simple for charities to make Programme Related Investments through expert intermediary institutions



Looking forwards

- New opportunities afford specific benefits for investing charity

The Potential of PRI



Q. What's in it for the investor?

A. Why spend your money once when you can use it many times?

Firstly, we help more people more often. Rather than simply exploiting conventional investments (invested outside the sector) and non-returnable grants, we have an opportunity to think more creatively and use our money more directly and many times over.

Secondly, we can leverage additional funds. Using charitable money and resources creatively through PRI has great potential for levering in additional money from private and public partnerships. For instance, theoretically, several of the larger disability charities could co-operate in creating, with a conventional venture capitalist, a Social Venture Capital Fund for disability initiatives. Investors would seek a competitive rate of financial return combined with benefiting people with disabilities. Charitable funds could be used to incentivise the corporate sector to make use of tax credits, leveraging private investment. Alternatively, if larger well-established charities made loan guarantees, they could add the value of their credibility to smaller charities enabling the smaller organisation to access finance from commercial providers. Combining the creativeness of charities with the expertise of financial institutions and using charitable funds as leverage means that, as a sector, we can double our money, recycle our income and make less go further. Larger charities working together can help build the infrastructure of the sector itself.

Thirdly, we can support beneficiaries directly (as one of our case studies shows). In addition to supporting other voluntary organisations that share our charitable purposes, PRI can play a vital role in enabling charity beneficiaries into self-sustaining and self-supporting activity. There are already precedents to this work in the world of community-based housing associations, where such organisations have capitalised and provided business start-up assistance to local enterprises that create jobs and deliver essential services in communities under-served by the private market.

Fourthly, PRI is a low risk investment. Naturally past performance is no guarantee of future performance and, as is set out in the second half of this guide, PRI requires careful administration. It should be noted however, that Community Development Finance Institutions boast extremely high repayment rates. Over 4 years from foundation, Investors in Society (the forerunner to Charity Bank) approved loan or guarantee facilities for 150 charitable projects and organisations – only 1 ever defaulted. Many of the initiatives showcased and discussed in the Magic Roundabout are less risky than some stock market investments.... and the traditional grant.

If you make a grant you never get your money back. As one finance director has observed, this means that a grant is a loan with 100% risk! And, as we shall see, the

management of loans is, in fact, though not identical, similar to the management of grants.

A question of culture?

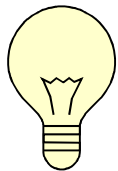
As a chief executive of a large national charity has put it: 'The possibilities are almost as many as we choose to explore. What we need is a change of thinking to charities having a more rounded, a more holistic funding policy in which a variety of types of investment are exploited. PRI is an opportunity, for us all.'

Yet it is a challenge too.

For although Programme Related Investments are not a more risky form of investment than conventional investments, adopting new approaches is a challenge that faces trustees, chief executives and finance directors alike - and one that requires a significant mind shift that *may* seem uncomfortable.

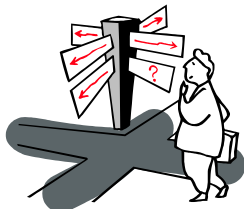
While a few charities are becoming more active, the sector as a whole has not been fast off the social investment starting blocks. The biggest barriers seem to be mindset, risk aversion and lack of knowledge. Yet, historically, charities have often been breeding grounds of creativity and innovation.

Traditional investment and fundraising strategies should not be replaced - but they can be complemented. We face the challenge now of how we can stimulate a broad economy of funding, deploying additional tools and, recycling our resources to do justice to all our causes.



Summary of this section's key points

- Programme Related Investments enable investor charities to use scarce charitable reserves to support charitable activity directly
- Programme Related Investment enables charities to recycle disposable funds
- Programme Related Investments can leverage further funding
- Charities can invest in training and work creation schemes that benefit beneficiaries directly
- Programme Related Investment is a low-risk investment
- If we are to exploit the potential of PRI, we must be willing to challenge inherited assumptions



Looking forwards

Some charities have already discovered the value of PRI...

The Pioneers

The successes of PRI pioneers provide real-life illustrations of the power of PRI. The lessons that the pioneers have learnt could be equally developed by large operating charities, both in the way that they make investment decisions and, if they have them, in the way they administer grants to support the work of smaller charities working in the same field.

PRI can support beneficiaries directly

PRIME is a national not-for-profit organisation encouraging the over 50s to set up in business. 2.7 million people between the ages of 50 and 65 are economically inactive – yet research shows that when people in this age group start businesses, they are twice as likely as younger counterparts to be successful.

The PRIME Loan Fund offers financial support to business ventures. The loan fund breaks new ground by helping those over 50, who are not in work and who cannot raise the finance from conventional sources to set up in business.

Enabling people aged 50 to 65 to become or remain economically independent and continue to contribute is a key objective of Help the Aged. This is why Help the Aged and Age Concern have made a Programme Related Investment in the PRIME Loan Fund by giving guarantees for part of the Loan Fund.

Paul Cann, Director of Policy and International Affairs at Help the Aged explains. “Help the Aged and Age Concern recognised that they shared a strong view on the need to support people in their 50s who had withdrawn, reluctantly, from the world of work and enterprise. Working together they created a vehicle for promoting “third age” enterprise and work which could appeal to ‘younger older’ people. The creation of the PRIME brand helped us reach a younger group than our traditional beneficiaries, and channelled resources and expertise of two large charities into a focused, dynamic new body to help to alleviate pensioner poverty.”

The Esmée Fairbairn Foundation and Aston Reinvestment Trust

The Esmée Fairbairn Foundation is exploring how to get greater value from its asset base. As a first step, and to gain experience, in February 2002 the Foundation made a loan of £200,000 to Aston Reinvestment Trust (ART), a Community Development Finance Initiative which makes loans to social enterprises and small businesses in the Birmingham area. The investment was from the Foundation's grants budget and has been made as a loan to ART at 2% below base rate (or minimum 2% whichever is higher) over 5 years. Interest will be paid over this period with the principal to be repaid at the end.

The investment has significantly increased the amount of money that ART can on-lend to social purpose projects. One example is Oscott Horticultural Services.

"We needed a £15,000 loan to buy equipment, including sit-down mowers and a vehicle, and help with the cash-flow of a newly-launched company", says Keith Grice, Oscott Horticultural Services' operations manager. "But my high street bank asked for my house as security." Oscott is a non-profit company employing people with learning disabilities on gardening and grounds maintenance projects. When it needed a loan for its launch it turned to Aston Reinvestment Trust.

The loan, lent at 1.25% above base rates, (and derived from Esmee Fairbairn's investment in ART) has proved essential in the Oscott's development. "We're creating employment for three people with learning disabilities through contractual work with churches, colleges and schools." Says Grice. "We also have four learning disability trainees on placement from a local organisation and another four from other sources, as well as to teenagers who are on work experience from school. Without the loan, it would have been difficult to get this off the ground. "

For Esmée Fairbairn, restructuring a sensible portion of the grants budget as loans means that some of the assets can be recycled – using them many times over instead of just once.

Nicola Pollock, Programme Director, Social Development explains: "We invested in ART as a pilot. It is one way for us to test how we can make charitable money go further. Our main purpose will always be to make grants, but providing other options, such as loans, extends what we can offer."

Nicola continues: "Lending through ART enabled us to work quickly and efficiently. ART is an established Community Development Finance Initiative with a strong track record, is known in the local area and has the experience to assess and manage loans to small organisations which would not otherwise be able to borrow money. These loans lead to jobs and generally contribute to the regeneration of some of the poorest parts of the UK. This partnership is a good way for us to invest in areas which need it without having to manage a large number of small loans ourselves.

We will use the experience of the loan to ART to investigate whether we should make other loans. In future we may also explore ways of investing our assets for social purposes. It is important that those of us responsible for charitable funds ensure they are used in the most effective way."

ART's Business Manager Martin Allcott explains: "We see this loan as a helpful step, one that could be followed by other progressive organisations. The arrangements include flexibility for us to engage with both social enterprises and small businesses in the Birmingham area when regular bank finance is unavailable or doesn't go far enough. All of our borrowers have to show positive social outcomes in our criteria together with an ability to repay. That is the important discipline which makes our lending re-cyclable. In a wider sense, our loan from Esmee Fairbairn is also valuable in levering in other support to help us meet demand."

Northern Rock Foundation

Northern Rock Foundation (NRF) receives 5% of Northern Rock plc's pre-tax profits.

Over the last 3 years, Director Fiona Ellis and her team have been thinking laterally about how they gain maximum usage from this income.

'In a conventional grant making model we would have two quite obvious options,' Fiona explains. 'Either invest a small part of the annual income to build gradually an income bearing endowment or distribute our income on an annual basis as a series of non-returnable, project-focused grants.'

'In fact there is a third complementary and, in some instances, more efficient way of using our charitable funds.'

In 2001, NRF were approached by The Centre for Life, a registered charity and one of the country's most successful Millennium projects. It combines a visitor attraction focussing on bioscience with education and research facilities looking at genetic research and ethics. It is on the edge of Newcastle City Centre in an area ripe for regeneration. The Centre had a trading subsidiary and, by putting its building to mixed use, income streams from lettings.

Unfortunately, however, the Centre was slightly ahead of its time and regeneration of the surrounding area had not happened quite as quickly as had been hoped and envisaged. As a result, many of the Centre's rental units lay empty. At the same time, arising from initial construction costs, the Centre had outstanding commercial loans of £1million. Whilst able to service and pay off the principal on these loans, this was expensive and distracted charitable funds. So the Centre for Life approached NRF for a 3-year grant worth £300,000 to develop its educational services.

'It was a good project and a good organisation that, despite some difficulty in maximising rental income in the short term, was certainly sustainable in the medium to long term as a regenerated local economy developed around the Centre. So the grant looked like a good spend.'

'A good spend: but not the smartest.'

Instead, NRF made an interest-free £1million loan to the Centre repayable over 10 years with a 3-year repayment holiday to be used if necessary to ease cash flow.

The £1million will be fully returnable enabling NRF to re-use their funds. Fiona explains that whilst NRF has foregone potential gain (or loss) on the stock market the cost of making this loan is likely to be no more than the grant or even less - yet the value to the recipient is considerably more.

Meanwhile the Centre has used the loan to pay off its commercial loans, thereby liberating funds to be recycled into its core educational services.

‘Our trustees are remarkably open to new ideas and willing to test them. Their willingness was demonstrated when David Carrington of the Social Investment Task Force came to talk to them about the concept of Programme Related Investment. PRI was a new concept - but not a threatening one. The Trustees have no desire to turn the Foundation into a charitable sector bank; they are interested in pursuing new ways of making charitable money do more work. This hardly constitutes ‘conventional philanthropy’ but they do apply ‘habitual prudence’ and that is no bad thing.’

‘We couldn’t make an interest-free loan every time’, Fiona notes, ‘but the principle is certainly transferable: we’ve used Programme Related Investment to invest directly into social purpose. We’ve spent less than a grant would have cost, the Centre has freed up crucial funds and we can recycle our money over and over. It’s a complete win-win!’

In addition to making a Programme Related Investment directly in a charitable organisation, NRF has also worked through a particularly innovative Community Development Finance Institution. And so the winning continues...

The Citylife Employment Bond

NRF have invested £500,000 in the Newcastle Citylife Employment Bond. Citylife issue zero-interest bonds to individuals, private businesses, and (in this instance) charitable trusts. They then take the capital raised and make an interest bearing investment in a social purpose business venture – in this case Places for People Group (formerly North British Housing Association), enabling the construction of social housing and support services. The interest made by Citylife on the capital is then put to work on other social schemes within Newcastle. Instead of being used once, money is recycled around a diverse range of employment initiatives.

When the bonds mature, original investors get their money back, having foregone only low interest rates but having facilitated a raft of social purpose projects which, for want of access to working capital, would otherwise have been unable to get off the ground.

For example, to facilitate micro-credit loans by Street UK to entrepreneurs with no other source of business finance; to support the hardest-to-reach unemployed people back into sustained jobs through Tomorrow’s People Trust; to set up a community enterprise launderette; and to support a range of other projects helping tackle unemployment in the city. The synergies between projects are also important to the Bond – for example, Tomorrow’s People hold outreach sessions at Bewick Court, a social housing scheme, which is under refurbishment, and have helped unemployed residents into jobs. After just one year, five partner organisations have seen 844 clients, helped 136 into employment and another 175 into training. A great start, and a huge impact from money, which is guaranteed to be handed back to investors after five years.

Martin Clark, Director of Employment Initiatives at Citylife, comments: ‘We recognise that it was a big challenge for NRF to make such a large PRI investment, but it has changed the way we think about our Bonds, and it will make an enormous difference to hundreds of people’s lives – and still be handed back to the Foundation to be used again after five years. It seems like commonsense once you’ve done it. I hope their example encourages and challenges many others.’

Fiona Ellis, Director of NFR, concludes: 'This approach to making money work harder is a challenge to grant makers, who are usually averse to lending over giving, but the NRF trustees wished to set an example for others to follow and hope that other grant making trusts will seek to maximise their assets in a similar way. It is an exceptional contribution that demonstrates that we can be flexible in delivery methods with our grants. Again, we can recycle our money whilst using it to leverage far greater social value than conventional investment and grants could ever have achieved on their own.'

'For too long charitable funds have been subjected to a simple 'Invest and spend' regime that has failed to appreciate their true value. It's when we think laterally about our investments that that we sweat our assets harder.'

Here then are real, innovative, inspiring examples of how, in making charitable reserves and grants budgets work harder, large charities and charitable foundations can use their resources to fill the finance gap, make their own funds go further, strengthen a charity's capacity to innovate and even enable the sector as a whole to deliver and sustain social change. Charities can set about using their money and skills in innovative ways, assisting themselves and others in creating sustainable income streams.

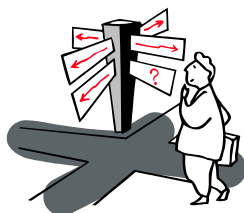
There will always be a place for more traditional grants and investment strategies. PRI offers us a complementary tool.

Are we up to the challenge of exploiting it?



Summary of Part 1

- Programme Related Investments are low risk investments that make a financial return for the investor at the same time as supporting charitable work.
- The value of charitable investments far outstrips the value of the income that they generate. Yet conventional charitable investments do not directly promote charitable activity.
- Grants made by charities to other charities can be spent only once.
- Programme Related Investments are a simple means of making scarce charitable resources work harder.
- Real-life examples demonstrate that Programme Related Investments are a critical source of finance for charitable organisations that would otherwise be unable to sustain or develop benefits to beneficiaries.
- PRI is a valuable addition to the investor's and the grant-maker's repertoire.
- PRI is a win-win.



Looking forwards

The second half of the Magic Roundabout unpicks the practicalities of PRI

The legality of pri



Q. Can **we** do it?

A. In a word: yes

To re-cap

Social investment describes a particular approach to the supply of finance in which the returns are measured not purely in financial terms but also in social benefit achieved.

PRI is a form of social investment whereby charitable organisations either select to take a lesser financial return on investment in return for developing the charitable aims of a charity with similar charitable purposes; and/or restructure a portion of their grants budget as a series of returnable investments.

The Charity Commission uses the expression “social investments” to describe investments which are intended to carry into effect the charity’s objects and their current guidance on PRI can be found at www.charity-commission.gov.uk/ccpri.htm.

This short section unpicks the permissibility in some detail, in order to reassure charities of the clear legality of this simple and effective tool.

PRI and charity investments

The obligation upon charity trustees under the Trustee Act 2000 is to preserve and enhance the charity’s funds for its charitable purposes. So, where charity trustees have funds that are not immediately required for their charity’s charitable purpose they must conserve them and, where appropriate, invest them to be used for those purposes in future.

The trustees are obliged to obtain the best financial returns for the charity’s funds consistent with the general investment powers and duties of charity trustees and any restrictions that may apply in their particular case. For tax purposes, investments will be regarded as being made for charitable purposes and for the benefit of the charity if they are commercially sound.

However, there is a crucial distinction between investments which are used by a charity to help it achieve its charitable purposes and traditional financial investments.

It is perfectly permissible for charity trustees to accept a lesser rate of financial return than they could otherwise expect in order to assist another charity *in furtherance of its own charitable objects*.

The rules which otherwise apply to the way in which trustees exercise their investment powers under the Trustee Act 2000 and the general law have no application to investments that directly support the investor charity's own charitable purposes. For example, an animal rescue charity with spare cash can make an interest free or low-interest loan to a charity to build an abandoned cats sanctuary. Because the money is being applied in furtherance of the charity objects, there is no obligation to try to achieve any particular level of return.

A programme of PRI cannot simply be taken in substitution for a programme of financial investment. Neither is it permissible to sacrifice an element of financial return to invest in charitable purposes generally or some other particular charity without regard for its purposes.

It is not open to trustees to sacrifice part of the financial return on any funds that they are obliged to invest in order to achieve a social return unless the financial returns sacrificed can be viewed as part of what the trustees are entitled to expend in furtherance of the charitable objects. The animal rescue charity could not, for example, make an interest free or low interest loan to preserve an historic ship.

In a nutshell, however, it is perfectly acceptable for charities to use a part of their investment portfolio to fund PRI.

PRI and charity grants

Any charity that can give grants to other charitable organisations can, instead of making a traditional grant, lend the money or use its funds to back guarantees or invest in shares to finance the project, unless this is specifically prohibited in the charity's governing document.

In short: if you can grant it, you can lend it.

This, of course, opens the possibility of grants budgets being deployed many times over.

Points to note

From the point of view of a charity wishing to invest in this way, there appears to be little to discourage it. However, there are two key points to note.

Firstly, if they expect to be repaid, trustees may be led into parting with larger sums than they might otherwise grant. This potentially affects the ability of the charity to carry out its objects. If projects fail and the charity suffers a loss, it will have prejudiced its ability to act in future. Therefore when evaluating whether to make a Programme Related Investment and at what level, trustees should give due weight to the risk that the money may not be repaid and the impact which that might have on future beneficiaries.

We have seen that investments made by Community Development Finance Initiatives attract extremely low default rates. This is certainly a point in favour of

making Programme Related Investments: it also emphasises the expertise CDFIs have in undertaking due diligence in loan assessment and active portfolio management.

A second and related point is the lack of relevant experience that is believed to exist in many charities that could potentially make Programme Related Investments. Whilst the skills of appraising loan applications, supervising implementation and monitoring performance are *similar* to those required when undertaking conventional investments and making grants, they are not identical. It is essential that Programme Related Investments achieve the desired social returns and that these returns are measured in some way. The danger otherwise is that poor implementation and supervision results in a higher failure rate with the result that the charity's funds are dissipated more rapidly than was intended. Administering and accounting for PRI is covered on the following pages.

Investment Options



Q. How do we make programme-related investments?

A. PRI may take the form of a loan, loan guarantees and indemnities and (though it is less usual) shares. PRI may also be made in partnership with a Community Development Finance Institution (as our case studies above demonstrate): indeed this may be the most appropriate route in to PRI.

Loans

Loans may take a great variety of forms. Nevertheless, the defining characteristic is an obligation to repay. There is no need to include an obligation to pay interest at any particular level or at all. Any obligation to repay the original loan or interest can be structured in many ways to suit the circumstances.

From the point of view of the recipient charity, the trustees may well feel inclined to accept an offer of a substantial loan from a sympathetic charity with both hands. However, if the charity is unincorporated the trustees will be personally liable to repay any loan out of their own pocket if the charity's assets should prove insufficient. The trustees of an unincorporated trust may therefore well ask themselves why they should incur the additional risk of repaying the loan and whether a grant, albeit of a lesser amount, would leave them feeling more comfortable in their beds at night.

This is sharply in contrast with the position of trustees of incorporated charities who are not personally liable for the debts of the charity unless they have acted improperly in running the charity's affairs.

In addition, there is a significant psychological barrier to the concept of enforcing repayment. The prospect of one charity issuing proceedings against another for the recovery of a loan, possibly leading to the winding up of a charity is clearly unattractive. Care will need to be taken in drafting repayment obligations that are conditional on cash flows in order to minimise this risk.

Conversely, where trustees have lent money to another charity, the trustees are under a legal duty to seek repayment under the agreed terms, even though they could have made a grant of a similar amount if they had chosen to do so. Depending on the wording of the contract terms, the trustees could seek an order from the Charity Commission in a suitable case to the effect that it was expedient in the interests of the lending charity not to enforce the loan. However, it may be difficult to establish that it is "expedient" and a charity which acquired a reputation for being a 'soft touch' would probably rapidly find that a true programme-related investment programme was unsustainable.

Most charities making loans in this way set up a revolving loan fund, with the idea that repayments from loans already made will add cash to the fund for new loans. By

emphasizing the revolving nature of the fund, participating borrowers feel responsible for repaying their loan. Experience of such funds has shown a high repayment rate.

Guarantees and Indemnities

Guarantees and indemnities are a useful tool whereby the charity, instead of making an immediate transfer of funds as is the case with a loan or an investment in shares, promises to a third party to be responsible for the obligations of the beneficiary charity should it fail in some way.

The “investor” charity is only contingently liable depending on the outcome of circumstances. The investor charity’s trustees will need to give careful thought to what financial provision they should make against the contingent liability of a guarantee or indemnity becoming immediately due and payable. In the meantime, the investor charity still has the use of its funds. With careful planning the same asset base could be used to benefit a range of projects in this way.

Programme-related investment offers interesting opportunities to use charity assets more intensively. But before the potential becomes a reality trustees on both side of the equation need to develop a fuller awareness of the possibilities, the skills they will require to operate a programme-related investment programme and, perhaps above all, a new attitude which owes more to the mindset of venture capitalists than grant administrators.

Shares

An investment in shares generally implies no repayment of the sum invested. Classically the ownership of shares gives the right to a dividend (when declared) on profits available for distribution and a right to vote at the AGM. Buying shares in a company provides it with start-up capital. It is only possible to recover the sum invested by a sale of the shares, which may be difficult in a small enterprise.

When charities receive dividends, these are paid out of taxed income. Gift aid on the other hand, can be paid out of the profits before tax. Most charities investing in shares in this way would therefore prefer to receive any return in the form of gift aid payments. However, there may not be a choice over this matter.

Although it is possible for a charitable company to be limited by shares as opposed to guarantees, there are probably no more than a handful of registered charities presently set up as companies limited by shares. The opportunity to invest directly in a charity through shares is therefore for the most part non-existent. It would be necessary to create a new company to be the recipient of the investment in shares.

Charities are, however, increasingly coming together to form joint ventures in the form of arms-length companies to which the charity contributes both shares and/or loans to carry out particular projects. In addition, programme related investments could be made in activities that are in themselves within the charitable objects of the investing charity, even if the organisation is not itself a registered charity. The rules are the same as those for grants and loans. The investing charity may only supply funds that will be applied within its charitable objects.

Partnerships with Community Development Finance Institutions

We have already seen through case studies that Esmee Fairbairn and Northern Rock Foundation made Programme Related investments through a Community Development Finance Institution. Working through a CDFI that has existing expertise in making and administering loans is a convenient route in to PRI as the example of Peabody Trust demonstrates.

Peabody Trust have developed a partnership with Charity Bank which allows Peabody to make their assets sweat harder – and Charity Bank to extend the range of services they offer.

Peabody Trust have deposited £500,000 with Charity Bank.

Charity Bank use Peabody's funds to on-lend to London-based charities, thereby ensuring that Peabody's investment remains programme-related, their charitable purposes being to 'help the poor of London.'

'Very simply' explains Peabody's Finance Director, 'we have chosen to deposit a prudent portion of our reserves on a double-bottom line basis. We take 2% return on our investment safe in the knowledge that our funds are being put to direct social use. Also Charity Bank has an incredible record of repayment so this is not only sensible from a social perspective; though the investment is made below market rates it is an extremely low risk investment.'

'It has been very simple to administer. So long as Charity Bank have £500,000 on or available for loan to London charities at any time we can easily establish an audit trail to demonstrate that our investments are on-mission – or programme-related. We made our initial investment 3 years ago and review it on an annual basis.'

Administration Matters



Q. How do we actually make it work?

A. Administering PRI through loans, shares, indemnities, or guarantees will have much in common with the administration of grants. Yet, there are also some significant differences.

This section it looks at the policies, assessment criteria, decisions on terms and monitoring processes that will be essential components in moving successfully towards making PRI.

Many of the administrative aspects described here will be familiar to grant-making trusts. Thus experienced grant-makers may feel quite comfortable that they can extend their expertise to making loans. Others may feel that this is new territory for them. These organisations may wish to consider a partnership arrangement with an experienced body so that all the administration is undertaken for them on policies and terms that are agreed in advance. Some of the earlier case studies set out examples of charities working with CDFIs and banks to achieve this sort of partnership

Policies

Before an organisation undertakes PRI, it will need to consider the policies that will guide the decision-making process. Points to consider when drawing up the policy framework in which PRI will operate include:

- Acceptable risk levels – the policy will need to address the issue of possible loss of funds, possible failure of projects.
- Amounts that the programme will invest – there may be a minimum and maximum level for this type of support.
- Types of organisation the charity will consider for support in this way.
- Types of activity the charity wishes to support in this way.
- Types of support it will consider, giving due consideration to loans, guarantees and equity investment. A charity may decide to support organisations in one form only. This policy decision may be linked to the policy on the types of organisation and the types of activity the charity wishes to support.

Assessment

Building on the policy framework, the investing charity will be able to set assessment criteria to guide the assessment process and ensure that the right information is gathered for the decision to be made.

There are two key areas in the process for making social investment decisions:

- Project assessment
- Assessment of the financial health of the applicant

Project assessment

The activity for which the funding is required has to fit within the policy framework. The investing charity needs to invest in activities that are within its charitable objects. The activities that are likely to be suitable for this form of support are those where there is an existing or potential income stream. The activity should be one that generates income in order to repay a loan or in order for the activity to be self-sufficient. It is likely therefore, that support is needed to fund initial asset purchase or working capital. The application needs to include adequate information to:

- Describe the activity
- Explain how income will be generated from the activity
- Determine what assets and staffing requirements will be required
- Determine working capital requirements. This needs to incorporate an explanation of the life cycle of the activity, showing the steps in the activity, timescales, and milestones in the project so that the amount of working capital needed is fully explained. A cash flow forecast will be needed as part of this section.
- Understand the key factors that will lead to success or failure of the project. These are likely to be focused on the income generation, but there may be other factors. This information needs to show to what extent these factors are in the control of the applicant, or whether the key factors are completely outside their control. Sensitivity analysis should show the effect of changes in the key factors, such as a delay in income generation, and assess the impact of such a change.
- Understand the benefits that will be gained from the project, demonstrating how the project will contribute to the achievement of the investing charity's objects. As with many projects, the plan should identify key milestones, likely outcomes and express targets as appropriate depending on the nature of the project.

As well as financial information, the application needs to demonstrate that sufficient market research has been undertaken. Marketing aspects of the proposal will underpin all the financial projections.

In order to assess the viability of a project, an assessor will find it useful to consider:

- Breakeven analysis
- Payback period

These are both helpful in assessing the risk of a project. A project that has high fixed costs will only breakeven with a high level of take up and is therefore more risky. Similarly, a project requiring cash investment which takes a long while to recover that cash investment through income (payback period) is a higher risk.

Assessment of the financial health of the applicant organisation

As with project assessment, assessment criteria need to be grown from the overall policy framework. Undertaking distinct assessments on both the projects and parent organisation is a useful way of systematically reviewing an organisation's suitability as a potential receiver of PRI.

As noted, the investor should draw up policies concerning overall risk profile and organisational type of charities to be considered by PRI. The assessment process should be designed to make a decision about the organisation's ability to repay a loan or produce a return. The information needed about the applicant will include:

- Copies of past accounts (it is usual to look at accounts from the past five years)
- Evidence of track record – this may be evident from the accounts, but additional information may be necessary. For example, the investee may be required to demonstrate experience in generating income.
- Description of activities currently undertaken and funding for those activities.
- Details of existing borrowings
- Details of the management team and governance structure and effectiveness

Assessors will need to use the information to help them to assess whether the organisation has the management it needs for this type of commitment.

Assessors will need to look for experience, as well as considering the scale of the new project in the context of the whole organisation.

The assessor also needs to look for indicators of adequate financial health. For example, an organisation that already has significant borrowings may not be in a position to commit to further loan repayments. Additionally, an organisation heavily dependent on one source of income may be vulnerable to change in that funding. Further information would be needed in those circumstances to assess the level of risk inherent in that dependency.

Decisions on terms

Having gathered the information detailed above for the assessment processes will assist in the setting of suitable terms. Investors can set a policy framework for terms, but most investors operate some flexibility in order that they may devise suitable terms for the project they are investing in.

Loan terms

These need to set out the repayment schedule and the basis for any interest payable. The cash flow forecast will assist a lender to agree a repayment schedule that is achievable. In addition, understanding the risk profile of the project and the sensitivity of the income projection will assist the lender to judge whether a repayment holiday should be granted for, say, a year, to allow the project time to get off the ground. Understanding the profitability will help to determine whether interest should be charged or only charged at a low rate. For example, if a project is aimed at generating income from a commercial market, then it may be reasonable to expect a

reasonable interest rate return on the loan. However, if a project is being undertaken on low margins or on a not-for-profit basis within a community marketplace, then the lender may choose to further support the project by lending on an interest-free basis.

Security

Charities and community groups frequently cannot obtain loans from commercial lenders because they cannot provide security in the form of tangible assets. It is common practice for loans to be given only where the borrower has a building or other major asset that can be given as security. The lender potentially can sell the asset to recover the amount of the outstanding loan in the event of default by the borrower. In practice, this leads to a poor outcome for both parties, as the borrower has lost the use of the asset and the funds and the lender often does not recover the full value of the loan. Taking security in this manner is therefore not always compatible with achieving the charitable objectives of either party, in addition to the common situation that the borrowing charities have no assets.

Hence, it may be more appropriate to consider lending without security in this traditional form.

Borrowing Communities

Some charities and other organisations operating loan funds allow for a different form of security to be offered. This is based on the personal guarantee often required by commercial banks, but with a major difference. A group of individuals may come together as a community of guarantors or a borrowing community to support a loan. Each individual can guarantee an amount they can afford and the guarantee is limited to that amount. The guarantee is not joint and several, as is normally the case in most commercial loans, so the lender does not have the right to sue one individual for the full amount of the outstanding loan. In this way, a number of supporters may underwrite a loan, but limiting the amount, they would have to provide should the guarantee be called upon.

Guarantees and Underwriting

For this form of support, the terms will need to state when the guarantee will be called upon. A charity may provide a guarantee for a loan that may be on commercial terms. This may well be included in formal loan documentation and the charity will need to obtain legal advice on the agreement.

A borrowing community can be set up to back up this arrangement as a third tier. In other words, the larger charity provides the formal guarantee to a commercial lender, but then accepts the guarantees from a borrowing community.

Note!

Where an organisation has existing borrowings, the existing lender may have already taken security, for example by taking a mortgage over the property. It may be possible to take a second mortgage, but there will have to be sufficient value in the property to make this viable.

Even if there is property and security for existing borrowings, there is a danger that your loan will rank low in the priorities in the event of a winding up or receivership. In addition, an organisation could obtain a bank overdraft after your loan has been advanced and you could find that the overdraft has priority over your loan. You should therefore consider carefully whether a charge over the assets of the organisation can be obtained. Usually a floating charge will be available, meaning that you have first call on the assets of the organisation such as stock, debtors and cash in the event that the organisation defaults on your loan.

Monitoring

As with grants, charities lending funds or providing support in other forms need to ensure that the funds are being used for charitable purposes. However, with grants, this may only be a matter of receiving reports on how the funds have been used. For loans, equity stakes and guarantees the monitoring will focus on the on-going progress of the project or organisation, with regular assessment of the prospects for recoverability or a return. For each of these three broad situations, the position will be slightly different.

In addition to monitoring the financial health and progress of the recipient charity, investing charities will need reports on progress towards the achievement of the project's outcomes. The investing charity should establish at the outset how these will be monitored, depending on the nature of the project. For example, targets may be set for the number of people to receive a service and reports should monitor progress against this target.

Loan Monitoring

A lender will need to establish a system for monitoring that repayments are being made on time. This can be a simple system based on the cash receipts. Once a repayment is late, this should trigger some form of response from the lender. It may simply be a telephone call or a letter, but early action is advisable. Support and help at an early stage may help the borrower. Further delays and defaults should also trigger appropriate actions, and can escalate up to meetings and action to collect the debt as appropriate. Lenders may need to develop a policy framework for dealing with these situations so the desired balance of actions is achieved and the action is proportional to the size of loan.

In addition to this type of monitoring, lenders will need to consider the amount of regular financial information they will wish to receive. It is usual for quarterly management accounts to be sent to lenders, but this may not be necessary for small

loans. Annual audited accounts may be sufficient in this situation, particularly if repayments are kept to schedule. Note that the loan documentation will need to include information requirements as a condition of the loan.

Equity Monitoring

Where an investor holds shares in a venture, they are also likely to want regular financial reports. Again, the frequency of the reports should be proportional to the level of interest. If you take a stake of 50per cent or more in a venture, then you may well consider monthly management accounts to be appropriate.

In addition, for a large holding, board representation may be advisable and is common practice amongst venture capitalists. This should not be seen as a negative – providing advice and support may be one of the most productive ways of helping the venture, in addition to the hard cash.

Monitoring the performance of an enterprise may be most usefully achieved by identifying the key indicators, and monitoring whether these are improving. These can be common ratios used in a business context, such as debtor days to monitor collection rates of income on credit sales, or they can be qualitative indicators that show whether the enterprise is thriving, such as customer satisfaction.

Guarantee Monitoring

Again, proportionality is important. A significant amount provided as a guarantee does require some monitoring. Regular reports to show that the lender is keeping up repayments on the loan and some financial reports to demonstrate the overall financial health of the enterprise should be obtained.

Accounting Matters



Q. How do we account for investments?

A. In this section we look at the accounting treatment for each of the options in the accounts of the investing charity – loans, equity and guarantees. For completeness the treatment of grants is also covered.

The fundamental point underlying the suggested treatment is that PRI decisions are taken in order to further the charity's objects, rather than on purely financial investment criteria. In terms of accounting, PRI is different from ethical or socially responsible investment, where the need to maximise returns remains. The investing charity is undertaking PRI as part of its charitable activity, not as an investment activity. This affects the accounting treatment significantly.

Loans

on the balance sheet

Typically a loan will be shown as an investment under fixed assets on the balance sheet with the current portion of the loan, (i.e. that due within 12 months), shown under current assets. Because Programme Related Investments are not made under normal investment criteria, and the returns may be lower than those required for investment assets, they might be shown in a separate sub-category within fixed assets or current assets – "Programme Related Investments". Other terminology may be used, such as "revolving loan fund" or similar, but the nature of the asset and accounting treatment will need to be explained in an accounting policy.

in the sofa

Interest receivable is investment income and is normally shown as a separate category within the incoming resources. However, the underlying purpose of PRI justifies treating it a category of income within activities in furtherance of the charity's objects'. It is envisaged that any provision for non-recovery necessary as a result of an impairment review or write off for bad debts should be treated as an expense under 'charitable expenditure' as a cost of an activity in furtherance of the charity's objects.

Equity

on the balance sheet

Equity investment in any unlisted company will be shown as an investment on the balance sheet under fixed assets. Similar to loans above, it is advisable for these shares to be shown within a sub-category of fixed assets called s. Details of the equity are then shown in a note to the accounts as unquoted shares. At the balance sheet date the market value of the equity would need to be ascertained. For unquoted shares, it is likely that the shares would be shown at cost, with a review of the business to see if any impairment in value has occurred requiring a write down in the balance sheet value.

in the sofa

Dividend income would normally be treated as investment income within the incoming resources of the charity on the SOFA. However, the underlying purpose of PRI justifies treating it a category of income within “activities in furtherance of the charity’s objects”. Any provision or write down in value required as a result of an impairment review would then be shown as an expense under the ‘costs of activities in furtherance of the charity’s objects’ on the SOFA.

Guarantees

A guarantee is a contingent liability and as such should be disclosed in the notes to the accounts. Typically the guarantee will be to underwrite a loan provided by a third party. If the whole loan has not been drawn down at the balance sheet, then the notes to the accounts should disclose both the year-end liability and the maximum liability guaranteed. Further the notes should detail the conditions under which liabilities might arise as a result of a guarantee and any uncertainties that are expected to affect the outcome. Should it become likely that the guarantee will be called upon, then the amount will have to be brought into the balance sheet as an actual liability rather than a contingent liability.

Grants

in the sofa

A grant should be treated as an expense under a separate category of grants payable within ‘charitable expenditure’ in the SOFA. If the grant is made under stage payments, then not only should the amount paid in the financial year to the recipient be treated as an expense, but if there is a constructive obligation to pay any or all of the remainder of the grant then any additional amount should be treated as a creditor and also shown as an expense in the SOFA.

Conditional Grants

Under PRI, it is sometimes the case that the investing charity makes a grant, but attaches conditions that make the grant repayable in certain circumstances. For accounting purposes, care is needed to assess the status of such a grant. It may in fact be a loan, repayable in normal circumstances, but written off if the recipient cannot repay. It may properly be a grant, but for restricted purposes. Should the restrictions no longer apply, then the funds should be returned to the donor. Grants

that are returned in this way would be shown as negative expenditure in a similar way to grants that are awarded but never drawn down.

Annual Report

In addition to the reporting of PRI activity in the financial statements, consideration should be given to aspects of the trustees' annual report. The charity SORP requires the investment policy to be stated and a commentary on the performance of investments to be provided in the trustees' annual report. A separate section should be considered for performance related investment, clarifying the purpose of the activity and how it fits into the overall strategic direction. This will also distinguish this activity from investment activity to achieve a return.

In addition, PRI may impact on the reserves policy of the charity, depending on the extent of the activity, the risk profile and the type of PRI undertaken.

A final word?

Who knows, maybe in 20 years time a new age of individual giving will have dawned. Government grants will have expanded, lottery ticket sales will have recovered, all the UK's companies will donate 1% of pre-tax profits to social action and an ever expanding stock market in a period of unprecedented growth will sustain charity investments and boost the endowments of grant-making trusts.

But right now would you bet your own money on any one, let alone all, of those things actually happening? We can't control the future. But we can develop ourselves. We have the resources. Do we have the courage?

It is clear from all available evidence that reliance on time-limited grants and charitable donations is not a safe place to be. For the voluntary sector to flourish into the coming century new financial instruments are required to catalyse and enable enterprise and growth. Sensibly broadening our investment approaches to allow us to exploit greater latitude is not risky: the status quo is risky. PRI is about sweating charitable assets harder - asset sweating not asset stripping. Sticky money, enlightened self-interest, some of our answers lie within. So if charity funding is in trouble here's to the Noah Effect: no more prizes for predicting rain – we only get a prize when we build an ark.

This is a practical guide but at the end of a ride on a magic roundabout one may feel entitled to a small rhetorical flourish. Hence, the penultimate word lies with the visionary Goethe and his suggestion that:

“Concerning all acts of initiative and creation, there is one elementary truth, the ignorance of which kills countless ideas and splendid plans:

The moment one commits, Providence acts too.

All sorts of things occur to help one that would never otherwise have occurred. A whole stream of events issues from the decision, raising in one's favour all manner of unforeseen incidents and meetings and material assistance which no person could have dreamed would come their way. Whatever you can do, begin it. Boldness has genius, power and magic in it. Begin it now.”

Yet if we can dream in poetry perhaps we are, after all, better off investing in prose. So the final word must go to one of the pioneers of PRI, an investor who observes:

‘Once you've done it, it just seems like commonsense.’

glossary

We have included a glossary for two reasons: some of the terms used in this report may not be familiar to all readers; and the field of Social Investment is relatively new and so universally agreed definitions do not exist. This simple glossary of phrases commonly used in the context of voluntary sector funding Social Investment reflects what the writers of the Magic Roundabout mean when we use certain terms in this report. It is indebted to the Social Investment Task Force report's original glossary and Ros Boyle at the Community Development Finance Association.

Charitable Purpose

Charitable purposes are characterised by a desire to benefit others for the common good. To be a charity the purposes of an organisation must be exclusively charitable. Charitable purposes come under four broad headings which can be grouped as the relief of financial hardship, the advancement of education, the advancement of religion and other charitable purposes for the benefit of the community.

Community Business

Community Businesses are Social Enterprises that have a strong geographical definition and focus on local markets, operating on a not-for-private-profit basis providing goods and services that are affordable and accessible - often in an area where private business is unwilling or unable to provide such services.

Community Development Finance

The provision of debt and equity finance in communities or markets where mainstream financial services are weak and which are therefore undercapitalised. Community Development Finance thus provides financial services for both for-profit businesses and for social enterprise.

Community Development Finance Institutions (CDFIs)

CDFIs are the vehicles that deliver Community Development Finance. The UK Social Investment Forum describes CDFIs as 'financial service providers whose mission specifically requires them to achieve social objectives.' They have a double bottom line of financial sustainability and social impact, both of which are essential to their mission and success. They supply capital and business support to individuals and organisations that are often refused these services by mainstream financial services providers, focusing on disadvantaged communities and under-served markets. An excellent and free guide, 'CDFIs – a new financial instrument for social, economic and physical renewal' is available from the UK Social Investment Forum - see useful contacts.

Community Development Venture Capital Fund

A particular type of CDFI that specialises in equity investments as opposed to loan finance. CDVCFs are relatively new to the UK and are usually run for-profit, offering a return to investors, albeit at a lower estimated return than conventional venture capital.

Community Economic Development

Developing the provision of goods and services and employment at a local level. Developing the economic wealth of a neighbourhood. Defined by Greater London

Enterprise as 'a range of activities and interventions creating local wealth and employment, and pooling skills within the community for the benefit of local people.'

Community Foundations

Grant-making trusts that build and manage endowments for the long-term benefit of voluntary and community groups within a specific geographic area. Donations are raised from the public and private sectors and from individuals to provide perpetual income from the interest paid on the endowment.

Ethical Investment

Investment that takes account of ethical considerations, avoiding certain businesses deemed to be 'unethical', and/or specifically targeting those that promote positive environmental or social impacts. Naturally, there is no universally agreed definition of what is and is not 'ethical'. The term is often used interchangeably with 'Socially Responsible Investment', (see below) and is most commonly used in the financial services retail market.

Equity

A share of ownership of a business, hence the term 'shares' to describe units of equity. Holders of equity own a share of the success or failure of the business. A key issue is how their ownership rights can eventually be converted into money via their 'exit route'.

Programme Related Investment

Investments that are undertaken to advance primary charitable purpose as well as for financial gain.

Social Enterprise

Trading for a social purpose. It is important to note that the term can refer *either* to an organisation *or* a type of activity. Social Enterprises trade for a primarily social purpose and seek to be viable trading concerns: 'social enterprise' can take place in a voluntary or community that is committed to income diversification but that does not generate sufficient trading income to re-classify itself as a Social Enterprise. Social enterprise can be a verb or a noun.

A wide range of organisations fit the definition of Social Enterprise, including Co-ops, community business, trading arms of charities and a variety of other businesses that use their trading activity to meet social goals such as job creation, the delivery of local services and providing opportunities for those in disadvantaged communities of geography and interest. Social Enterprises are 'Value led, market driven' (the title of a book by Andrea Westall, published by the IPPR)

Socially Responsible Investment

Socially Responsible Investment combines investors' financial objectives with their commitment to social concerns such as social justice, economic development, or a healthy environment. It describes investment that takes account of the investors' values and objectives, whether social or environmental, whilst also delivering a financial return. The term is often used interchangeably with the terms Ethical Investment and Social Investment. The UK Social Investment Forum (UKSIF) champions all forms of Socially Responsible Investment- see below in useful contacts

Social Investment

Social Investment is often used interchangeably with the term Socially Responsible Investment. However, it is increasingly used by some to mean investment that builds human or social capital. These people would say that whereas SRI uses more conventional commercial financial instruments to make investments (e.g. ethical ISAs and pension funds etc), Social Investment uses non-conventional investment vehicles (in particular Community Development Finance Institutions) and targets under-invested communities.

Venture Capital

Venture capital provides long-term committed, risk sharing equity capital together with experience, contacts and advice in order to help unquoted companies to grow. It seeks to increase a business's value without taking day-to-day management control. Venture capital shares risk with the other owners of the business. Its financial return is dependent on the business's growth and profitability and ultimately on the increase in value.

Venture Philanthropy

Venture Philanthropy is the process whereby, individuals invest money and time in social organisations: it takes the principles of venture capitalism and applies them to philanthropy. According to US not-for-profit Social Venture Partners, "Venture philanthropy means funding organizations with not only financial resources, but also management and technical support. This support is focused on enabling nonprofits to build greater organizational capacity and infrastructure via long term, engaged relationships with investees."

useful contacts

on social investment

The Charity Commission's current guidance on PRI (called Charities and Social Investment) can be found at

www.charitycommission.gov.uk/supportingcharities/casi.asp

The full report of the Social Investment Task Force can be downloaded at www.enterprising-communities.org.uk. The website also features news of progress on recommendations. The Task Force report is an accessible and engaging document and a good way of thinking further about social investment.

The Community Development Finance Association is the membership body for UK Community Development Finance Institutions. You can visit the CDFI at www.cdfa.org.uk

To find out more about Socially Responsible Investment in all its forms visit the UK Social Investment Forum at www.uksif.org or telephone them on 020 7749 4880. UKSIF produce an excellent and free guide, 'CDFIs – a new financial instrument for social, economic and physical renewal'.

David Carrington is a freelance consultant and former chief executive of PPP Healthcare Trust and Barings Foundation. David's website at www.davidcarrington.net contains a series of articles on Programme Related and other forms of Social Investment.

Read a highly entertaining article on PRI, 'Horse manure and Grantmaking' at www.foundationnews.org/CME/article.cfm?ID=1950

Visit the Charity Bank at www.charitybank.org.

The Local Investment Fund (www.lif.org.uk), the London Rebuilding Society (www.londonrebuilding.com) and Industrial Common Ownership Finance (www.icof.org.uk) are all CDFIs. Triodos Bank (www.triodos.co.uk) lend to many social purpose business ventures. Their websites all illuminate further the value of social investment.

Bridges is the UK's first Community Development Venture Capital Fund. Launched in May 2002 you can visit Bridges at www.bridgesventures.com

on social enterprise and social entrepreneurship

The Sustainable Funding Project is an NCVO initiative supported by Centrica plc that encourages and enables voluntary organisations to explore ways in which they can generate income through mission-related trading activity. The project's web pages are at www.ncvo-sfp.org.uk and unpick what social enterprise means for the voluntary sector

The Social Enterprise Coalition is an alliance of Social Enterprises throughout the UK. You can visit the Coalition at www.socialenterprise.org.uk

At the US Institute for Social Entrepreneurs you can access a series of free introductory articles and the Social Enterprise Sourcebook, containing profiles of 14 nonprofits that are successfully operating social purpose businesses at www.socialent.org

Social Firms UK is a membership association supporting organisations that are 'creating New Employment for people with disabilities & disadvantages in the open labour market' www.socialfirms.co.uk

The School for Social Entrepreneurs, based in London and Edinburgh, supports individual social entrepreneurs, many of whom work in social enterprises – www.sse.org.uk