

## Programme Related Investment

Programme Related Investment (PRI) is based on an *investor* approach to funding organisations and activities. An investor approach focuses more on outcomes and on enabling the development of the funded organisation. This is in contrast to the type of funding that is, in effect, the purchase of a service. David Carrington in his report for the Community Fund<sup>1</sup> highlights the observations of the President of The Rensselaerville Institute at a Community Fund seminar (January 2002) that:

“His primary focus had shifted from “what are we buying?” to “what will help grantees do their work better?”

This is a fundamental basis for PRI.

### Forms of PRI

PRI increases the range of ways that funders can help organisations. Commonly, organisations developing PRI will make loans as well as grants, but may also take an equity stake, in a similar way to venture capitalists. It may also involve the provision of guarantees, enabling a new organisation to gain access to funding it would otherwise only obtain with difficulty. Voluntary organisations and social businesses (businesses with a social objective) find it difficult to access traditional forms of borrowing, and their legal structure as a not-for-profit means that they are frequently under-capitalised compared to similar for-profit enterprises.

You do not have to engage directly in the process of making loans or taking a stake in a social business or a charity. You can deposit funds with a Community Development Finance Institution (CDFI). Taxpayers can gain a valuable tax credit by placing funds with CDFIs and you can still receive a good rate of interest. CDFIs lend your funds to charities and other social businesses and have experience of managing the process. Their track record on debt recovery is good, despite the fact that these may be proposals a traditional lender would spurn. Some charities have chosen to place significant funds with CDFIs as their way of engaging in PRI.

So the options for charities wishing to engage in PRI include:

- Lending directly to other charities and organisations acting within your charitable objects, as an alternative to grants.
- Offering a combination of loans and grants to organisations they fund, depending on the nature of the activities. Some funders may lend funds, but as “soft loans” where no interest is expected and the repayment schedule is flexible, even to the extent of waiving repayments altogether and effectively converting the loan into a grant.
- Putting in capital as a longer term equity stake in a social business. This may be similar to charities setting up trading subsidiaries for some activities and this could be the route to fund joint ventures with other charities. A mix of equity and loans may also be appropriate in these cases.
- Guaranteeing a loan taken out by another organisation. “Blue-chip” charities can offer this form of help to smaller charities.
- Depositing funds in a CDFI, either on commercial rates of interest, reduced interest rates or forfeiting the receipt of interest altogether.

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<sup>1</sup> The Investor Approach – A Way Forward for the Community Fund, June 2002, by David Carrington

In practical terms, some charities find it simplest to deposit funds with a CDFI. Others set up their own revolving loan fund, set up with an injection of cash in the first place. Others have been awarding a mix of grants and loans to partner organisations with whom they work for many years, using judgement in individual cases as to which is more appropriate.

### Structuring PRI for your charity

As well as considering the forms of PRI most appropriate to your charity, you may wish to consider how this will fit with the overall financial strategy of your organisation. For some, PRI will be a different approach to distributing funds from the income budget. Alternatively, you may wish to earmark a proportion of funds traditionally invested in the stock market for PRI. You can, of course, do both. What is clear is that PRI is a way of the charity achieving its charitable objectives, rather than an investment purely to generate a return, which is then applied to the charitable objects.

“Conventional investments involve the acquisition of an asset with the sole aim of financial return which will be applied to the charity’s objects. Social investments, by contrast, are made directly in pursuit of the organisation’s charitable purposes. Although they can generate some financial return, the primary motivation for making them is not financial but the actual furtherance of the charity’s objects.

The normal rules on financial investments for example, in the Trustee Act 2000 therefore do **not** apply.”<sup>2</sup>

As PRI transactions are part of the charitable activity rather than the investment activity of a charity, then the following accounting treatments apply:

- PRI debtors may be shown under fixed assets and current assets as a separate category (for example loans advanced to borrowers)
- Loans should be assessed each year for “impairment” and written down if necessary
- Amounts to write off loans to their recoverable value and bad debts will be part of the charitable expenditure, not a loss on revaluation of an investment
- Costs incurred in connection with PRI (e.g. staff time) may be categorised as charitable expenditure

If you do decide to develop a loan portfolio, then you will need to consider the effect this will have on your reserves policy and other key ratios, such as the amount spent on charitable activities. Moving into PRI will have an effect on the balance and structure of your organisation.

### Suitable targets for PRI

Loans and other forms of PRI will not be suitable for every organisation and will not replace grants entirely. Where they may work well:

- An organisation may be setting up or expanding an activity that can become self-sufficient through the income it can generate. Your charity may be interested in helping to fund such an initiative because it has objectives that overlap with your own charitable objectives, or because it involves your beneficiaries in some way. For example, a charity working with disabled people may be prepared to put a stake into a business being set up by disabled people in their beneficiary group, thereby achieving some of the charity’s objectives.

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<sup>2</sup> Charity Commission guidance “Charities and Social Investment” published on the CC website 28 August 2003

- An organisation may need funding for its development – building up its fundraising or management infrastructure. The organisation has a development plan which shows that it will generate sufficient funds to repay a loan in the future.
- A locally-based organisation with similar objectives is well-placed to serve its local community. As a national organisation, you may wish to develop local organisations so that services are more responsive to local needs.

### **Managing the risk**

There are risks involved in PRI. For example, there is a risk that a loan made to an organisation will not be repaid. Appropriate assessment processes need to be in place before loans are advanced or equity stakes taken, although these may be seen as similar to the processes you would have in place for grant-making. Many CDFIs will engage in a more active way in the recipient organisations, similar to the way that some venture capitalists will. Thus they may provide management support as well as monitor loans more closely than is customary with most grant-making. The bad debt ratios of those involved in PRI are low compared to commercial lending.

### **Benefits of PRI**

There are benefits for the recipient organisation, as well as for the funder. The recipient organisation is receiving support for its own development in most cases – funding that will enable the organisation to grow and develop. The culture inherent in making loans or other forms of PRI is different to the culture of grant-making. Organisations that borrow funds need to establish a sustainable income to both repay the loan and then fund their activities into the future. This is in contrast to the culture of constantly searching for the next tranche of grant-funding. Organisations that can earn their own income from a variety of sources are more independent and more robust.

The most obvious benefit to the funder is that lending money that is repaid will enable the funder to use that money again to help another organisation. However, there are also other less tangible benefits. PRI is a way for charities to achieve their objectives. The outcomes achieved by the recipient organisation with your funding can be counted as part of the overall social outcomes the sector seeks to achieve. PRI can act as a “lever” to multiply the social outcomes achieved.

PRI is consistent with the development of outcome-based funding and the investor approach to funding organisations. Charities may wish to consider whether PRI will serve their needs in their approach to funding other groups and organisations with similar charitable objects. Charities may wish to make part of their investment portfolio available for PRI or change the way they use some of their charitable expenditure. Developing this approach could mean real benefits for all charities, large and small