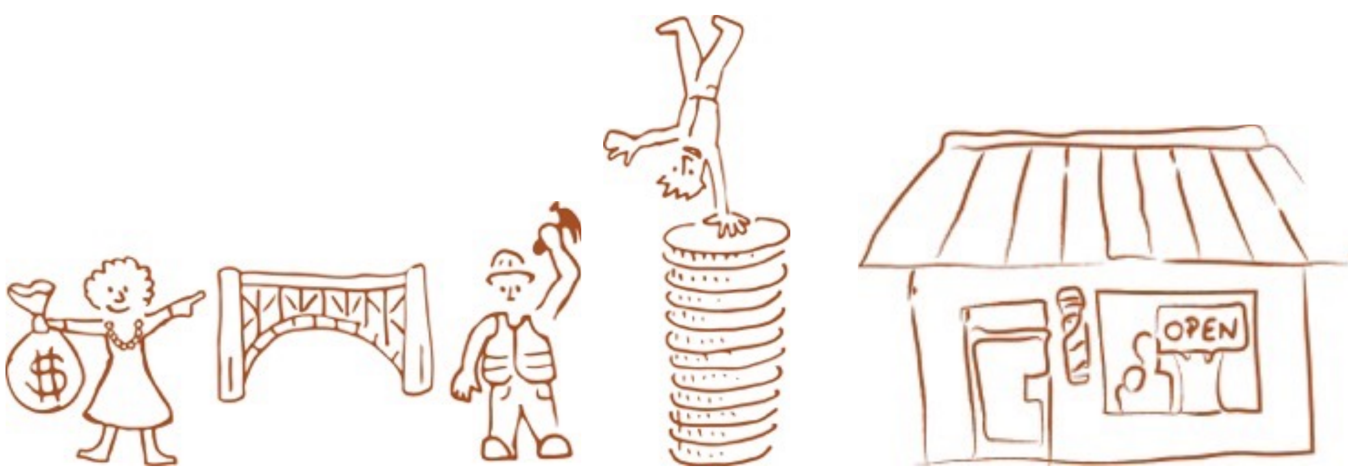
Mary Reynolds Babcock
Foundation

helping to move people and places out of poverty

Program-Related Investments Policies and Guidelines



Mary Reynolds Babcock Foundation
Policies and Guidelines for Program-Related Investments

Revised January 2017
(reflects changes approved by board in June 2016)

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I. About PRIs

A Program-Related Investment or PRI is an investment by a foundation, usually made at below-market rates, with the primary goal to support a charitable project or activity. Conceived by the Ford Foundation in 1968 and included in the Tax Reform Act of 1969, PRIs must meet three criteria:

1. The investment's primary purpose must be to advance the foundation's charitable objectives;
2. Neither the production of income nor appreciation of property can be a significant purpose; and
3. The funds cannot be used directly or indirectly to lobby or for political purposes.

PRIs are used by foundations large and small – private, family, community and corporate – for such purposes as housing production, microenterprise lending, business development, non-profit facility renovations, equipment purchases, or working capital for non-profit organizations. PRIs are generally made in the form of deposits, loans or equity investments and may be structured in various ways, such as subordinated loans, revolving funds, loan guarantees and linked deposits. The recipient of a PRI can be a for-profit or non-profit organization, as long as the purposes are charitable and further the foundation's mission. For the purposes of MRBF's program, PRIs are made primarily to nonprofit organizations, often community development financial institutions (CDFIs).

Advantages of PRIs for funders include the use of assets for social responsibility; ability to recycle resources; flexibility to provide larger funding than typical grants; potential to leverage additional funds from banks, corporations or government; and the opportunity to help meet payout requirements during times of unexpected asset growth. (PRI principal counts toward payout in the year it is distributed and is added to payout requirements in the year it is repaid.) For borrowers, PRIs help create long-term, productive relationships with funders; leverage other investments by traditional financial institutions; and help raise capital for large projects.

II. History of PRIs at MRBF

The Foundation awarded its first PRI in 1981. Since that time, PRIs have been used in various ways, including developing worker-owned cooperatives and community land trusts; supporting community development initiatives in equity-scarce areas; advancing the protection and stewardship of natural resources; and providing access to land, housing and financial resources for low-income people.

From 1981-1999, MRBF made $2,445,500 in loans to 21 organizations, with a default rate of 5.5%. To protect itself from early problem loans, MRBF later instituted a policy of making PRIs only to intermediary organizations with expertise to make loans and offer technical assistance to loan recipients. Intermediaries are typically community development financial institutions (CDFIs), such as community development banks, revolving loan funds and credit unions. PRIs supported microenterprise lending, affordable housing production, land acquisition, and pre-development for community development projects.

The PRI program waned in the 1990s and was revived in 2005 as part of MRBF's new strategic plan to achieve its mission of moving people out of poverty. Since 2005, MRBF's PRI portfolio has included loan funds for affordable housing and business development, insured deposits in community development banks and credit unions; secondary capital for credit unions, and venture capital investments.

III. Maximum PRI Allocation of MRBF Assets

The Foundation is limited, at any given time, to outstanding PRIs totaling no more than $10 million of the Foundation's assets.

IV. Scope of Investments

The Foundation makes investments that support MRBF's mission of helping people and places move out of poverty. Through PRIs, the Mary Reynolds Babcock Foundation seeks to complement its grantmaking, extending the Foundation's ability to accomplish its programmatic goals while preserving its own assets for future use.

Size: $100,000 - $1,000,000, not to exceed 10% of recipient's assets under management or 10% of MRBF's maximum PRI allocation

Rate: For loans, the Foundation will charge an interest rate that is reasonable, adjusted for risk, and that still allows the borrowing intermediary to earn a spread that covers its lending costs and contributes to financial self-sufficiency. Typically this means staying just below the average cost of funds.

For insured deposits, the Foundation uses an interest rate that is one point below market rate. If market rates are below 1.5%, MRBF calculates the interest rate at one-half the market rate.

Private equity funds earn the rate of return of similar investors, according to the terms of the limited partnership agreement.

Term: 3 – 10 years
MRBF encourages potential borrowers to establish long-term relationships with lenders in traditional capital markets. The Foundation may renew a PRI for up to five years based on the following criteria:

- The social impact advances MRBF mission and current program priorities.
- The PRI is performing well on social and financial metrics.
- The organization is attracting investment from banks and other investors.
- The organization has a promising plan for increased impact and sustainability.

For renewing PRIs, MRBF will require that the current PRI be repaid and a new PRI disbursed under the new terms. In some cases, MRBF may elect to roll over the PRI without repayment of principal.

Structure: General recourse loans, certificates of deposit, secondary capital investments, loan guarantees and equity investments; others may be considered as appropriate.

Use: Community economic development, business development, affordable housing and access to financial services. Other uses can be considered. *Examples of ineligible PRI uses: purchase of real estate for use as office space (or any other purpose not directly related to community development), endowment, operating expenses.*

Eligibility: Nonprofit and for-profit organizations engaged in the acceptable uses in the MRBF target area. Preference given to MRBF grantees and intermediaries.

V. Selection Criteria

A. Program Content – The Foundation will consider only those PRI proposals that meet the objectives of the Foundation's programs.

B. Legal Requirements – A PRI must be made for a clearly charitable or educational purpose, and must relate to the program objectives of the Foundation.

C. Financial Criteria – The applicant must demonstrate a reasonable prospect for sufficient cash flow to finance its investment obligations and/or repayment. Most loans are general recourse, but an applicant may be required to have physical or other assets to secure the investment.

D. Management Capacity – The applicant must demonstrate the staff competence to operate the activity profitably and manage its financial operations. Examples include but are not limited to the staff's technical qualifications, the applicant's financial controls and accounting system, experience in the subject matter, existing assets, and the competence and accountability of its board of directors.

E. Financial Analysis – The applicant must provide a detailed financial statement and financial plan to ensure that it can realize a rate of return that will allow payment of interest and repayment of principal. Supporting documents might include a written business plan, a market or financial feasibility study, descriptions and financial statements of third parties, cash flow projections, and a description and appraisal of any security or collateral.

F. Acceptable Risk – The Foundation will assess the risk of each investment, seeking mitigating factors such as sound management capacity, clear underwriting criteria, a solid track record for loan repayment, and efforts to raise permanent capital. To further mitigate risk, total investments in any organization is limited to 10% of the total PRI portfolio, unless a portion of the investment is in an insured deposit.

VI. Portfolio Risk Allocation:

The Foundation uses the following risk allocation as a guideline to inform decisions by the Investment Committee and Board. Allocation percentages may be exceeded from time to time to meet program objectives.

Percentage of Total Portfolio Allocation	**Level of Risk**
20%	Conservative: No risk of loss [100% federally insured certificates of deposit in community development banks and credit unions]
20%	Conservative/Moderate: Potential for loss of principal roughly 0 – 10% [established and stable community development loan funds, large development corps]
20%	Moderate: Potential for loss of principal roughly 0 – 30% [less stable loan funds, development corps, nonprofit social enterprises]
30%	Moderate/Aggressive: Potential for loss of principal roughly 0 – 60% [start-up loan funds, development corps, nonprofit social enterprises with less borrowing and lending experience]
10%	Aggressive: Real opportunity to lose part or all of entire investment. Potential for loss of principal roughly 0 – 100% [this bucket to include any equity in community development venture capital, and certain other orgs]

VI. Accounting Procedures

The Foundation accounts for PRIs as a separate asset category. The IRS provides that all investments that qualify as PRIs are exempt from classification as "jeopardizing investments" (imprudent investments). Outstanding PRIs remain on the Foundation's balance sheet as a separate asset category until they are repaid or written off.

A PRI is counted the same as a grant toward meeting the annual IRS payout requirement. Interest payments received from the loan are considered as regular investment income, while principal payments increase the annual payout requirement by the amount of the principal repayment. The Foundation carries PRIs at cost unless it determines that the investment has become permanently impaired, at which time the Foundation will reduce the cost basis and record a loss on the investment. The Foundation will account separately for investments, grants and PRIs in internal accounts and in published annual reports.

VII. Decisions and Monitoring

A. Board of Directors – The Investment Committee has responsibility for recommending policy for the PRI program and for providing monitoring and oversight on behalf of the Board of Directors. The Investment Committee reviews staff recommendations for individual PRIs and makes recommendations to the Board of Directors for approval. The Board may give the Investment Committee authority to renew investments in the Conservative category. The Investment Committee reviews PRI reports twice annually to provide monitoring oversight.

B. Staffing – In general, a PRI program is more complicated and costly to administer than a grantmaking program, since it requires both program and financial competence. The level of monitoring is higher than on grants because the Foundation expects repayment of funds and a return on its investment. The Foundation's program and finance staff will work with external consultants to assess PRI proposals for program impact, financial feasibility and level of risk. The Program Director and Senior Finance Officer act as liaisons with consultants and are responsible for regular reporting to the Investment Committee and Board of Directors.

C. Due diligence – The program staff will work with financial and legal consultants to analyze and structure appropriate PRI instruments, monitor repayments and return on investment, and take appropriate action if and when PRIs become delinquent. Efforts will be made to co-invest and share due diligence costs with other foundations when possible.

D. Monitoring – PRI recipients are required to report quarterly on financials and at least annually on program impact to ensure that they are on track for program goals and interest and principal payments. Staff will contract with consultants as necessary for monitoring individual investments. The Investment Committee will review reports on the PRI portfolio semi-annually.

E. Delinquencies and Defaults – When information indicates that a PRI recipient is in danger of becoming delinquent on scheduled payments or is in danger of becoming or is in default of any promissory note terms, the staff will contract with a consultant to develop an appropriate monitoring strategy, recommend restructured repayment plans or workout strategies. The Investment Committee must approve any changes to the borrower's loan agreement and terms. Staff will make recommendations to the Investment Committee with regards to partial or full write-off of borrower's loan principal and/or interest payments.