COMMUNITY FOUNDATIONS & ECONOMIC DEVELOPMENT

Indiana Grantmakers Alliance
Wednesday, July 25, 2007
Objective

The State of Indiana plans to provide training and perhaps make limited grants to not-for-profit organizations, such as community foundations, for the purpose of assisting those organizations to support economic development in rural communities.
In 2005, Indiana created “OCRA.” OCRA is under the auspices of Lt. Governor Becky Skillman, as Secretary of Agriculture and Rural Development. The objective is to make economic development in rural communities a State priority.
To work with local, state, and national partners to provide resources and technical assistance to aid rural communities in shaping their vision for economic development.
OCRA Priorities

- Develop a strategy to attract and expand philanthropic capital;
- Attract and retain entrepreneurial talent;
- Generate creative practices/programs for rural work force development;
- Seek innovations in rural broadband development and deployment; and
- Expand health and human service delivery to reach marginalized populations.
OCRA created Rural Capacity Grants (“RCG’s”) as support designed to foster innovative approaches for rural and community level projects.
2006 RCG’s

RCG’s were granted to several community foundations for the purpose of spurring local economic development organizations or economic development activities within communities.
Types of RCG’s

Two types of RCG’s:
- Rural entrepreneurial support; and
- Work force and educational development.

Maximum grant is $150,000 each
Counties Receiving RCG’s in 2006

- Warren County – Project titled “Wabash Valley Workforce Consortium;”
- Putnam County – Projected titled “Knoy Research Center;”
- Ohio County – Supporting artists and tourism; and
- Clinton County – Project to start a Farmers’ Market.

Community foundations were either lead applicant or partners in each project.
Legal Background On Grantmaking For Economic Development
A community foundation, as a Section 501(c)(3) organization, is restricted in the types of projects to which it may provide support. It is also restricted as to the types of entities to which it may make grants. The projects must be “substantially” charitable.
Activities of Section 501(c)(3) Organizations

The Tax Code states a wide range of allowable “charitable” activities including:

“Religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.”
IRS Regulations’ Definition of “Charitable”

IRS regulations include as allowable activities:

- Relief of the poor and distressed or the underprivileged;
- Advancement of education or science;
- Erection or maintenance of public buildings, monuments, or works;
IRS Regulations’ Definition of “Charitable” (Cont.)

- Lessening of the burdens of government; and
- Promotion of social welfare to accomplish any of the above, or to . . . lessen neighborhood tensions . . . eliminate prejudice or discrimination . . . or to combat community deterioration . . .
Key to Satisfying IRS Regulations

For a grant by a community foundation to fit within the foundation’s “charitable objective,” it must be a grant to achieve one of the IRS-listed standards. At every decision point, the community foundation must ask itself: “State the charitable purpose for which this grant will be used.”
Prohibited Activities

Section 501(c)(3) organizations may not support activities that:

- Have a “substantial” non-charitable purpose; or
- Result in inurement to private entities or persons.
Substantial Versus Insubstantial Non-Charitable Purposes

There is no “bright line” test to demark “insubstantial” from “substantial.” It depends on the facts and circumstances of each grant. The best approach is to develop a two column chart showing the “charitable” versus the “non-charitable” consequences of the grant.
Private Inurement

This simply means that no more than non-incidental benefits of the grant can serve private interests or benefit disinterested persons. Examples include: private businesses, creators of a charitable organization or their family members, or a small group of individuals who receive financial gain from the grant.
Private Inurement (Cont.)

The fact that a non-incidental benefit flows to a prohibited group will not violate IRS regulations. The key is to make certain the primary focus and beneficiaries of the grant are a broad-based group that fits within the tax code definition of a charitable purpose.
Detailed Analysis Of Permissible Charitable Purposes
Charitable Purposes

- Relief of the poor and underprivileged;
- Advancement of science and education;
- Lessen the burdens of government; and
- Promote social welfare, eliminate discrimination, or combat community deterioration.
Economic development assistance that targets disadvantaged populations, or economically depressed geographic areas, qualifies as charitable activity because it provides “relief for the poor and distressed.”
Allowable Goals

The goals include:

- Promoting jobs for “long-term” poor, disabled, or elderly;
- Support job training for same; and
- Provide housing, retail opportunities, or places for jobs for poor and underprivileged.
Examples of Projects that Provide Relief to Poor and Underprivileged

- Stimulate economic development in areas inhabited by mainly low income, minority, or other disadvantaged groups;
- Provide low cost or long-term loans to create capital for business proprietors of that type;
- Encourage industrial enterprises to locate new facilities in economically depressed areas; and
- Construction or renovation of housing for low income families.
Examples of Programs that Provide Relief to the Poor and Underprivileged

- Buying of blighted land and converting it into an industrial park by providing tenant businesses with attractive lease terms but binding them to hire and train local unemployed persons. Give preference to businesses that will hire low skilled individuals; and

- A program that benefits the disabled by providing training and/or job opportunities.
Factors to Consider in Qualifying as Relief for Poor and Underprivileged

Factors to establish include:

- Does the project target a geographic area that is blighted or deteriorating economically;
- Is the project to assist minority or disadvantaged groups (elderly or disabled);
- Do the businesses receiving support have a record of difficulty in obtaining conventional financing because the owners are minorities or disadvantaged groups; and
- Is the aid targeted toward businesses that will remain in, or relocate to, the blighted area.
Factors to Consider in Qualifying as Relief for Poor and Underprivileged (Cont.)

- Will the assisted businesses provide training and jobs to unemployed or under-employed residents;
- Has a government agency designated the target group as “low income;”
- Has the government identified the area as “economically disadvantaged; and
- Do individuals suffer from “long-term” poverty and not temporary distress from natural disasters.
Factors Arguing Against Qualification

Factors to avoid include:

- Is the targeted community broad based or economically diverse;
- Do non-minorities or other members of non-disadvantaged groups receive the substantial majority of benefits;
- Do successful business owners benefit any more than “insubstantially” from the grant;
- Are businesses otherwise likely to provide training or jobs to local qualifying residents;
- Promotion of business in general is not a qualifying factor; and
- Grants must be narrowly targeted to qualifying group.
Advancement of Education or Science

Supporting education or science may include providing scholarships or training dollars, or assisting in the development of research sites in blighted areas.
Supporting students who have expressed a desire to use their abilities in furtherance of civic, cultural, social, and economic development is considered support of the advancement of education or science for a charitable purpose.

Providing social and economic development to training persons that are poor and distressed qualifies.

Providing assistance to an educational institution that is establishing an economic development program qualifies.
Examples of Advancement of Education or Science

- Support of a farm that would demonstrate the economic feasibility of environmental conservation was ruled to be both scientific and of broad public benefit as it would support local farming industry;
- Development of a blighted area into a biotechnological research and development center;
- Support of a biotechnology incubator whose goal was to broaden the industrial basis and foster jobs in the community by developing new products and processes; and
- Support to attract new industry to the community or encourage development of, or retention of, an industry in the community that is for the public benefit.
Supporting Education or Science Alone is Not Sufficient

In the case of grants to support economic development, the mere fact that the grant will enhance education or science is not sufficient. It must be to advance education and science for the purpose of enhancing economic development in an area that is “blighted” or “depressed.”
Erection or Maintenance of Public Buildings, Monuments or Works

Grants to entities that support economic development by “filling the gaps” on projects that could otherwise be undertaken by the government meets the IRS requirement. Developing infrastructure or constructing new facilities that may be used for business purposes qualifies so long as the benefit to private interest is minimal or insignificant.
Examples of Programs that Erect or Maintain Public Buildings or Works

Examples include:

- Preservation and renovation of an historic train station in the blighted area;
- Grant to fund construction of an aquarium and an adjacent hotel in a blighted or economically depressed area;
- Grant to construct an enclosed park/pedestrian thoroughfare in a blighted urban area; and
- Grant to a city transit authority to cover providing bus service to a disadvantaged area.
Lessening the Burdens of Government

Grants to the government or to organizations that are engaged in taking over government responsibilities meet the charitable purpose.
Examples of Programs that Lessen the Burdens of Government

Examples include:

- Grant to support tourism;
- Grant to expand a convention center;
- Grant to operate a prison;
- Grant to construct an apartment or office complex; and
- Grant to support government-mandated development programs.
Criteria to Fit Within the “Lessening the Burdens of Government”

- Government unit invited the organization to participate in the activity;
- Entity acts jointly with a government unit;
- The activity is an integral part of a larger government program;
- The government exerts control over the operation of the activity;
- The activity was previously undertaken by the government; and
- The activity pays the expenses of the government or government debt.
Elimination of Discrimination or Combating Community Deterioration

This is a “catch-all” charitable purpose phrase allowing a broader array of activities to fit within the definition of a charitable purpose. Each part of the phrase qualifies as a charitable purpose.
Examples of Programs that Promote Social Welfare

Examples include:

- Rehabilitation of housing for the poor in a depressed area;
- Revitalization of a depressed residential area;
- Education of any part of the population on the shortcomings of discrimination in housing or jobs; and
- Programs designed to avoid further deterioration of a community also qualify as having a charitable purpose.
Grantmaking Basics For Economic Development
Summarization of Grantmaking for Economic Development

The IRS has stated three points to consider in determining whether a community development group furthers a charitable purpose:

- Whether assistance is being provided to help local business or to attract new local facilities of established outside business;
Summarization of Grantmaking for Economic Development (Cont.)

- Whether the type of assistance provided to the community development organization has non-commercial terms and the potential to revitalize the disadvantaged area; and

- Whether there is a nexus between the business entities assisted and relieving the problems of the disadvantaged areas or between the businesses and a disadvantaged group, such as a minority, in the area.
Grantmaking for Economic Development

The following are factors to ensure that grants by a community foundation will not jeopardize the foundation’s IRS tax exempt status:

- Tax status of the potential grantee organization;
- Pre-grant inquiry to determine that the organization is capable of managing the grant;
Written grant agreement specifying how funds will be used, including promise that unused funds will be returned and that no funds will be used for lobbying;

If the grantee is not a charitable organization, arrangements to keep foundation funds segregated from non-charitable funds; and

Follow-up reports on how money was used.
Methods Of Support A Community Foundation May Use
Forms That Grant May Take

Grants by community foundations for economic development may be in forms that are not traditional, such as:

- Program-related investments ("PRI’s");
- Loans;
- Support to community development financial institutions ("CDFI’s"); and
- Equity investments.
**Program Related Investments (PRI’s)**

A PRI is a loan, loan guarantee, stock purchase, or letter of credit that the grantee uses for economic development. A PRI must:

- Have a primary goal of accomplishing one or more charitable purposes;
- No significant part of the investment may be to produce income or the appreciation of property value for the foundation; and
- No part of the investment is to lobby, support, or oppose candidates for public office.
Examples of PRI’s

Examples include:

- Loan at a below-market interest rate to a small business enterprise located in a deteriorated urban area owned by economically disadvantaged minorities who could not obtain conventional financing;

- Purchase of an equity interest in a business similar to the above where the purchase provided the business capital to provide jobs;
Examples of PRI’s (Cont.)

- Loan at a below-market interest rate to enterprise that employed a substantial number of low income persons in a deteriorated area even though the business was not owned by low income or minority persons;

- Loan at a below-market interest rate to financially secure company to induce company to establish a new plant in a deteriorated area where company would not have done so without loan because of high risks;
Examples of PRI’s (Cont.)

- Loan to a business enterprise that would enable the enterprise to obtain additional financing to launch an agricultural marketing business for low income farmers in a depressed rural area; and

- Investment in low income housing allowing for the rehabilitation or construction of such housing.
Community Development Financial Institutions ("CDFI")

A CDFI is a community development bank, credit union, or venture capital fund whose purpose is to support economic development in the community by making loans or accepting deposits or other investments. A community foundation may support a CDFI by providing it with capital that is then used to support economic development in a depressed community.
Examples of CDFI-Supported Operations

Examples include:

- Support of renovation and maintenance of a building in a public park that was subleased to a restaurant operator where the building had become derelict because of the declining area surrounding the park; and

- Operation of a theater in a depressed area to revitalize the community, provide jobs, and bring cultural activities to that area.
Community or Social Investments

A community foundation may make investments where the primary purpose is to produce income or appreciation, but the rate of return is less than would be earned on a private investment.
Examples of Community or Social Investments

Examples include:

- Investment in a company that would provide local jobs; and
- Purchase of tax exempt bonds or place deposits in a CDFI.

Caution needs to be exercised in such investments because the foundation’s rate of return is less than the market generally provides and may conflict with the foundation’s fiduciary duty concerning investments. The foundation must weigh the economic or social improvement advantages versus the loss of income.
Use Of Government Funds By Community Foundations
Grant of Government Funds

A community foundation that receives a grant from the federal or state government is subject to special restrictions that are unlike those when dealing with “private” money.

The agency making the grant has the power to set its rules with which the foundation must comply. Further, the government has accounting and recordkeeping rules independent of those set out by the grantmaking agency.
Restrictions on Grantees of Government Funds

Issues include:

- Right of the State to audit the community foundation’s books;
- Application of State “sunshine” laws to community foundation activities;
- Reporting obligations to the State;
- Requirements for “audit” or “review” status of community foundations’ financial records;
Restrictions on Grantees of Government Funds (Cont.)

- Need for separation of government from non-government money; and
- Right of community foundation to receive a “fee” from the government money to cover direct and indirect costs.
Applying The Rules To Community Foundations And Grants For Economic Development
IRS Position on Community Foundations and Economic Development

The IRS has approved of community foundation support for economic development. A community foundation may obtain “prior approval,” before undertaking the grant, by submitting a request for a private letter ruling to the IRS. This avoids subjecting the community foundation to risk. Also, to the extent “adjustments” are needed in the community foundation’s grant or grantee programs, the IRS will provide that advice in responding to the request for ruling. Grants to for-profit entities by community foundations have been approved where the money would be used for a charitable purpose.
Examples of Community Foundation Support for Economic Development

Examples include:

- Establishing a broad-based community program to support economic development within an economically depressed area that included promoting tourism, downtown revitalization, supporting a community college, and promoting training of the unemployed. Community foundation partnered with other entities, including for-profit entities, to support revitalization and job attraction;
Examples of Community Foundation Support for Economic Development (Cont.)

- Providing a loan to a non-profit real estate development entity that works with both private and public sectors to preserve and enhance the downtown and using proceeds from loan to purchase retail property that was then sold to developers who constructed condominiums for disadvantaged persons;

- Granting a PRI to purchase land for the development of an industrial park;
Examples of Community Foundation Support for Economic Development (Cont.)

- Working with a non-profit economic development entity by providing a PRI to complete financing of a business technology center; and

- Making a loan to an entertainment-based museum that was opening a new, multi-million dollar facility to attract tourists to the downtown and enhance economic activity in a depressed area.
Steps to Ensure a Charitable Purpose

- Obtain a government ruling that the area is blighted or requires redevelopment;
- Ensure that the project will offer training or employment to historically unemployed or under-employed people;
- Carefully document the nature of expenditures to show a charitable purpose through written grant agreements describing sponsored activities, budget, personnel, and objectives;
Steps to Ensure a Charitable Purpose (Cont.)

- Identify the economic development that will benefit the targeted community as opposed to individual investors;

- Assure follow-up reporting as to details of progress made in achieving charitable goals (the larger the grant, the more details required); and

- Preference for low skilled business or those that will employ minorities or other disadvantaged persons.
Fiscal Sponsorships

A fiscal sponsor agrees to support the activities of a person or group that is doing charitable work. A fiscal sponsor provides oversight and administrative services so that the group can focus on its mission. A fiscal sponsor also makes grants to the organization to carry out its work. The advantage is that the fiscal sponsor (community foundation) is better able to control how its grants are spent and the grantee organization is managed.
Fiscal Agency Arrangements

A fiscal agency relationship is one in which the community foundation receives money for the group and then “passes it through” to that group. Normally, there is little or no oversight of the grantee. However, in the case of a community foundation receiving and then granting government funds, the foundation will have continuing reporting duties and accountability to the government agency that made the initial grant. However, a fiscal agent runs the risk that as a “mere conduit,” the money is not used for a charitable purpose.
Issues to Consider in a Fiscal Sponsor Relationship

➢ Agreement between fiscal sponsor in project (i.e., a written agreement);

➢ What control does a fiscal sponsor maintain on the project;

➢ Is fiscal sponsor providing its own funds to the project or only money raised specifically for the project;
Issues to Consider in a Fiscal Sponsor Relationship (Cont.)

- Is fiscal sponsor charging an overhead or administrative fee that is reasonable;
- What happens to the funds and the project if the fiscal sponsor (community foundation) and its grantee decide they can no longer work together; and
- Does the sponsor have the time and skill to manage grantee.
Factors to Consider in a Fiscal Agency Arrangement

- Who are the groups or projects to be sponsored, and does the grantmaker wish to be associated with them;
- What types of oversight are appropriate for the grantmaker to assert; and
- What will be the cost to the grantmaker in maintaining the oversight.
Examples of Economic Development

The following are examples of economic development grants that have been used by community foundations outside Indiana:

- Scholarships with a “social compact” — recipients agree to remain in community and work with disadvantaged persons;

- Workforce Development — Scholarships to discourage “out migration” and for “non-traditional” beneficiaries;
Examples of Economic Development (Cont.)

- Entrepreneurial Programs – Provide education, coaching and seed money for entrepreneurs (if fit “charitable” definition);
- Start entrepreneur classes;
- Leadership training;
- Value added education – support traditional K-12 school system to retain excellent teachers and create new programs to help disadvantaged;
Examples of Economic Development (Cont.)

- Recruit and retain volunteers;
- Entrepreneurship program for middle school;
- Support child care – Poor and disadvantaged cannot go to work without adequate child care; and
- Youth Communication – Creating youth-managed affiliates for purposes of empowering young leaders with resources for community betterment projects.
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