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E N T E R P R I S E S

Mission Investing in Microfinance

A Program Related Investment (PRI)

Primer and Toolkit

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Reference Documents about MicroCredit Enterprises

Numerous source documents about MicroCredit Enterprises are referenced throughout this Toolkit. To avoid unnecessary paper consumption and to provide the most current information, these documents are available at the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents which can be found on the left side of every webpage.



Executive Summary

Investing in Microfinance

For the private foundation (inclusive of family or company-affiliated foundations) that supports poverty alleviation initiatives, this Primer and Toolkit discusses the basic policy, financial and legal issues concerning mission or program related investing in microfinance. Included are model legal documents that a foundation may use to implement its decision.

A program related investment (PRI) is predicated on a foundation accepting some investment risk to advance its charitable mission. The authors hope this Toolkit and Primer will be useful for foundations interested in microfinance PRIs generally and PRIs offered by MicroCredit Enterprises specifically.

This Toolkit describes two PRI investment opportunities offered by MicroCredit Enterprises. Both options are straightforward, permitted under federal law, easy to implement and simple to administer.

MicroCredit Enterprises is a California nonprofit corporation that is a tax-exempt public charity under Sections 501(c)(3) and 509(a)(1) of the Internal Revenue Code. MicroCredit Enterprises is a private sector innovation which leverages private capital to provide small business loans to poor entrepreneurs in developing countries. The special focus is sustainable economic development for families living in extreme poverty (\$1.00 per day or less).

As an open source, highly-collaborative business model, MicroCredit Enterprises is managed by committed, pro bono senior business executives. MicroCredit Enterprises itself operates with a small budget and on a very thin margin (about 3% of overseas MFI loan portfolio).

In the spirit of partnership, MicroCredit Enterprises offers this Primer and Toolkit into the public domain for informational purposes. No copyright claim to this booklet or its contents is made, provided acknowledgement is given to MicroCredit Enterprises and/or the authors and provided that this material is not reproduced for sale.

While the materials in this Toolkit are applicable to foundation PRIs in general, the materials will focus specifically on two PRIs offered by MicroCredit Enterprises:

PRI Option One – Interest-Bearing, Secured Loan

A foundation can provide an interest-bearing *secured* revolving line of credit. Each \$1.2 million loan (the minimum required) supports up to 12,000 microcredit business loans which are, in turn, administered by established microfinance organizations in developing countries. MicroCredit Enterprises secures the line of credit with full recourse guarantees (10:6 collateral-to-loan coverage) provided by high net worth individuals and institutions (including other foundations). MicroCredit Enterprises seeks the most affordable loan terms commensurate with a foundation's risk profile since ultimately MicroCredit Enterprises' cost of borrowing is borne by poor women entrepreneurs in the developing world. A loan PRI option contributes towards a foundation's pay-out requirements at the time the loan is made, as explained in more detail in this Toolkit.

PRI Option Two – Guarantor

A foundation can guarantee loans to MicroCredit Enterprises. Each \$1 million guarantee (the minimum required) supports up to 5,000 microcredit business loans. The foundation maintains complete control of its assets, thus receiving all investment returns from its portfolio, but does not realize a return on the guarantee risk. In the event of an overseas financial loss, each Guarantor bears the loss on an equitable, pro rata basis with all other guarantors. A Guarantor PRI option contributes towards a foundation's pay-out requirements if the guarantee is called upon, as explained in more detail in this Toolkit.

Four foundations have made PRI investments to MicroCredit Enterprises. The MSST Foundation has made a PRI loan. The Oswald Family Foundation, Swift Foundation and Three Guineas Fund are Guarantors.

These two PRI options and a brief summary of the microfinance field are described in more detail in this Toolkit.



E N T E R P R I S E S

Chapter 1

Topography of Microfinance

A foundation interested in supporting microfinance poverty alleviation programs should understand the fundamental characteristics of three key microfinance organizational structures: (a) a microfinance institution, (b) a microfinance network, (c) a microfinance intermediary, vehicle or fund.

Microfinance Institution. A microfinance institution (MFI) is similar to a neighborhood bank located in a developing country. It has the same challenges and capital needs confronting any expanding venture, but with the added responsibility of serving economically-marginalized populations. Many MFIs are creditworthy and operationally self-sufficient with proven records of success.

An estimated 3,000 to 5,000 MFIs exist worldwide of which about 300 to 400 are creditworthy, that is, financially mature enough to borrow and repay loans. If a foundation makes a PRI directly to an overseas MFI, foundation staff must be equipped to conduct both financial and social mission due diligence, monitor the PRI, accept the foreign investment risk, engage in "expenditure responsibility" and consider the legal viability of investment documents in other countries.

Microfinance Network. A microfinance network generally describes a non-profit technical assistance provider that offers training, capacity building and consulting to MFIs. Microfinance networks are typically supported with foundation, donor and government funds. These organizations are vital, but usually do not directly provide investment capital to MFIs and are not, as a rule, PRI opportunities for foundations. Some microfinance networks do operate a microfinance intermediary or fund (see next section) as a subsidiary or "sister organization."

Microfinance Intermediary, Vehicle or Fund. A microfinance intermediary generally refers to a for-profit or non-profit organization accepting investments and, in turn, providing loans and/or equity financing to MFIs in the developing world. It can be administratively easier for a foundation to invest in a U.S.-based intermediary, especially if it is a tax-exempt public charity, since the foundation's due diligence responsibilities are undertaken in large part by the intermediary.

Further, the microfinance intermediary selects and administers a diversified MFI loan portfolio, saving the foundation the responsibility and expense of doing so.

As this toolkit goes to print, 74 microfinance intermediaries or funds exist. The Mix (<http://www.mixmarket.org/>) is a global information exchange with the most comprehensive listing of microfinance intermediaries. A PRI-making foundation is advised to investigate two sets of criteria: the financial health of the intermediary and its social mission focus. Both factors are discussed in more detail in this Toolkit.



Chapter 2

Principal Forms of PRI Microfinance Investments

Typically the major PRI options or opportunities in microfinance are secured or unsecured debt investments, loan guarantee commitments and equity investments.

Secured or Unsecured Debt Investment. A foundation loan to a microfinance intermediary is used to fund smaller loans¹ to a diversified, global portfolio of microfinance institutions (both non-profit and for-profit).

“The most common form of PRI is the loan.....Loan terms may vary widely, and in many cases, a flexible loan structure is the key to success. A loan can be secured or unsecured. It can require repayments periodically or in a lump sum on maturity and can carry a long- or short-term loan, according to the circumstances surrounding the project and the degree of risk the foundation is willing to take.

A loan is said to be "secured" if there is a specific asset to which the lender has claim if the borrower fails to make payment on the loan when due....A loan is said to be "unsecured" if there is no particular asset to which the lender has claim.”² “Of the foundations that made loans over the past 40 years, 75% achieved a zero default rate.”³

MicroCredit Enterprises offers foundations a debt investment PRI option that is fully secured for a five-year term at an interest rate commensurate with current market conditions for very low risk investments. The security for the foundation’s loan is provided by high net worth individuals and other foundations. The interest rate is not as high as a foundation could achieve from more aggressive investments.

¹ Some intermediaries also make equity investments in overseas microfinance institutions, a higher level of risk which a foundation should investigate and consider. MicroCredit Enterprises does not make equity investments in overseas microfinance institutions.

² Piton Foundation staff and Brody & Weiser, Program Related Investment Primer, Council on Foundations, 1993.

³ Sarah Cooch and Mark Kramer, Compounding Impact: Mission Investing by US Foundations, Social Impact Advisors, March 2007.

Loan Guarantee Commitment. A pledge of foundation collateral assets secures a line of credit from a third-party lender which, in turn, is used to make loans⁴ to a diversified portfolio of overseas microfinance institutions (both non-profit and for-profit). Unlike a debt investment, the foundation does not earn a return on its guarantee, but maintains control of its assets and therefore receives all investment returns from its portfolio investments.

“Guarantees have some advantages over direct investments:

The first is leverage: a foundation can accomplish more with limited resources because the foundation is not required to expend cash when it makes the guarantee....

The second advantage is that guarantees can help recipients to establish a good credit history. For a nonprofit organization to repay a foundation loan responsibly may have only a limited positive impact on the organization's credit rating with commercial lenders, but a guaranteed loan from a bank establishes a credit history that will help the organization obtain the next loan on its own.

The third advantage of guarantees is administrative: banks are experts at making loans and servicing them (i.e., calculating payments, billing and collecting). Foundations can avoid this added administrative burden by providing a guarantee on a loan that a bank will make and service.”⁵

MicroCredit Enterprises offers foundations a unique loan guarantee PRI option that meets all standard requirements for a PRI. A foundation that agrees to be a MicroCredit Enterprises PRI Guarantor shares the default risk on an equitable, pro rata basis with all other guarantors. Thus, the more guarantors, the less risk to the foundation, and vice versa. Plus, the foundation may exit the guarantee with eighteen months advance notice, a comparatively high degree of liquidity compared to most PRIs. However, unlike many other kinds of PRIs, typically guarantees do not count towards a foundation's payout requirement.

Equity Investment. “Equity investments (are) an ownership stake in a corporation, limited liability company, or partnership...typically (without) a fixed repayment schedule or a fixed interest rate. Equity investments are no less useful than loans, but their applications are more limited because equity investing most often involves a relationship with a for-profit organization, and such PRIs must be structured with special care. Equity investments also generally involve more risk

⁴ Some intermediaries also make equity investments in overseas microfinance institutions, a higher level of risk which a foundation should investigate and consider. MicroCredit Enterprises does not make equity investments in overseas microfinance institutions.

⁵ Piton Foundation staff and Brody & Weiser, Program Related Investment Primer, Council on Foundations, 1993.

than loans because lenders must be repaid before equity investors receive any return.”⁶

“As with any investment, foundations must consider the time...funds will be committed to a mission investment and hence unavailable for other purposes. In general, debt mission investments have shorter average expected timeframes than their counterparts.”⁷ And, “depending on market conditions and performance, private equity and real estate investments may be difficult to sell at the time a foundation desires to recycle funds. As a result, foundations should think carefully about their investment horizons, their exit options, and the liquidity risk of not being able to sell an investment at a given time.”⁸

While many financial intermediaries do offer PRI equity opportunities in microfinance, MicroCredit Enterprises does not offer foundations an equity investment PRI option.

⁶ Ibid.

⁷ Sarah Cooch and Mark Kramer, *Compounding Impact: Mission Investing by US Foundations*, Social Impact Advisors, March 2007.

⁸ Ibid.



E N T E R P R I S E S

Chapter 3

Issues and Trends for International PRI-Makers

A prominent and current study reports that “over the past decade, the number of foundations engaging in mission investing has doubled, and the new funds invested annually have tripled.”^{9,10} The report continues that “recently, the use of mission investments, including program-related investments (PRIs), has been expanding rapidly. Mission investments’ annual growth rate averaged 16.2% in the last five years.”¹¹

Indeed, foundations of all sizes are making mission-related decisions about their assets and financial activities. One recent study reported “thirty percent of all private foundations making mission investments...have assets totaling less than \$50 million, and 9% have less than \$10 million in assets.”¹² Indeed, the trend data show that “smaller foundations accounted for 44% of all new mission investment dollars in 2005, representing an annual growth rate of 22% over the past five years....”¹³

Concurrently, foundation support for global issues is on the upswing. In 2005, “adjusted for inflation, international giving climbed nearly 12 percent, far surpassing the 2 percent gain in overall giving.”¹⁴ Moreover, “in 2004, 670 funders awarded international grants, up from 636 in 2002. Newer foundations...have helped raise the level of international giving.”¹⁵

⁹ Mission investing or mission related investments are broad terms encompassing a foundation’s policy commitment to leverage and align its assets and investments in accordance with its program goals. Program related investments (PRIs) refer to specific investment instruments, such as loans, equity, guarantees, etc., as explained elsewhere in this booklet.

¹⁰ Sarah Cooch and Mark Kramer, *Compounding Impact: Mission Investing by US Foundations*, Social Impact Advisors, March 2007.

¹¹ Ibid.

¹² Ibid.

¹³ Ibid.

¹⁴ Loren Renz and Josie Atienza, *International Grantmaking Update*, Foundation Center, October, 2006.

¹⁵ Ibid.

That noted, making grants and PRIs directly to overseas recipients (in contrast to utilizing intermediaries based in the U.S.) is challenging. A 2004 survey of international funders by the Foundation Center found “a large majority of respondents agreed that it was now more difficult to fund internationally due to “the more demanding and uncertain regulatory environment” and “increased security risks abroad.””¹⁶

For smaller foundations, which typically have limited staff resources, the prospect of direct overseas grantmaking and PRI-making can present a formidable challenge. One study reports “...nearly 40% of all foundations said that an absence of staff expertise in mission investing is constraining their activity” in PRIs and “...a shortage of staff of staff resources or time is a barrier....”¹⁷

Indeed, there is a “tendency by newer international funders to rely more heavily on U.S.-based agencies to implement their programs.... Between 2002 and 2004, cross-border giving declined by 3 percent...while grants to U.S.-based international and global programs increased 49 percent....”¹⁸

“Investment intermediaries offer several potential advantages:

- Reduced financial risk: By investing in a pool of investments rather than one direct investment, a foundation can spread and lower its risk.
- Lower transaction costs and greater expertise: Intermediaries structure their operations and staff to make and manage investments in the most efficient and effective manner possible. Their expertise also helps to select investments that are less likely to end in default. In contrast, most foundations do not yet have the staff with the time and expertise to handle mission investments.
- Increased deal flow and size: Many foundations, particularly those new to mission investing, have difficulty finding investment opportunities. By working with an intermediary that has developed a steady flow, a foundation can expand its potential investments and also participate in larger-scale deals than it could afford on its own.
- ...Superior reporting...(and) reduced reputational risk....”¹⁹

¹⁶ Ibid.

¹⁷ Sarah Cooch and Mark Kramer, *Compounding Impact: Mission Investing by US Foundations*, Social Impact Advisors, March 2007.

¹⁸ Loren Renz and Josie Atienza, *International Grantmaking Update*, Foundation Center, October, 2006.

¹⁹ Sarah Cooch and Mark Kramer, *Compounding Impact: Mission Investing by US Foundations*, Social Impact Advisors, March 2007.

“One way to keep legal costs down...is for a foundation to invest through an intermediary.... Such intermediaries will often absorb the legal costs involved in investing in individual projects.”²⁰

Fortunately, numerous qualified and reputable U.S.-based microfinance organizations exist to partner with a foundation. Moreover, in addition to traditional program grants, various financial models for PRIs are in active use and ready to scale up.

In the case of MicroCredit Enterprises, four foundations have made PRI investments.²¹ The MSST Foundation has made a PRI loan. The Oswald Family Foundation, Swift Foundation and Three Guineas Fund are Guarantors. These two PRI approaches are discussed in more detail later in this Toolkit.

²⁰ Piton Foundation staff and Brody & Weiser, Program Related Investment Primer, Council on Foundations, 1993.

²¹ As of June, 2007.

Chapter 4

Legal Explanation of Program Related Investments

With Frequently Asked Questions

This document was prepared by Silk, Adler & Colvin at the request of MicroCredit Enterprises to describe the legal framework and requirements for program related investments (“PRIs”). This document is intended as a general discussion to help educate advisors of small to mid-sized private foundations, including family and company foundations. It is not a legal opinion. It is not an endorsement of any particular program related investment or investments.

Fiduciary Standards for PRIs

PRIs are mission-driven investments that are not subject to the normal prudent investment standards for foundations and foundation boards of directors. For legal purposes, PRIs are considered to be more akin to grants, which can be made purely to further a charitable purpose, without regard to any return on investment.

Specifically, the category of PRIs is an exception to the jeopardizing investment rule of Section 4944 of the Internal Revenue Code (“IRC”). Section 4944 prohibits a private foundation from making any investment in a manner “as to jeopardize the carrying out of any of its exempt purposes”.²² In plain English this means that Congress does not want a private foundation to make poor investments that jeopardize the charitable assets of a foundation. As we describe in more detail below, PRIs are not subject to the *jeopardizing investment* standards of IRC Section 4944. Therefore, penalty taxes do not apply to an investment if it qualifies as a PRI.²³

²² IRC Section 4944(a)(1).

²³ IRC Section 4944(c) reads:

(c) Exception For Program-Related Investments. For purposes of this section, investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes. The purposes described in IRC Section 170(c)(2)(B) are the same as those found in IRC

What is a PRI?

An investment must meet three requirements (each discussed in more detail below) to qualify as a PRI:

- The primary purpose of the investment must be to accomplish an exempt purpose. In large measure, this is a determination specific to each foundation, its mission and the proposed PRI.
- The production of income or the appreciation of property may not be a significant purpose of the investment.
- No electioneering and only limited lobbying purposes may be served by the investment.

1. *Primary Exempt Purpose Test.*

There are two parts to the primary exempt purpose test. First, the investment must *significantly further* the accomplishment of the foundation's exempt activities. Second, the investment must be such that it would not have been made *but for* its relationship to the foundation's exempt activities.²⁴

a. Significantly further sub-test. To meet this test, the foundation must determine that the PRI is consistent with one or more purposes described in IRC Section 501(c)(3). In addition, if that foundation has purposes that are more limited than those described in Section 501(c)(3), then the foundation must also determine that the particular PRI is consistent with the specific purposes of the foundation. For example, if a foundation's stated purpose is to promote the arts, then, a PRI to promote economic development in Africa might not be consistent with that foundation's exempt purposes, even though the PRI might be consistent under Section 501(c)(3) and might be permitted for another private foundation.

A foundation will need to review its own Articles of Incorporation or Certificate of Incorporation, along with any other restrictions that may have been placed on its assets to determine whether a PRI is consistent with that foundation's mission.

If a PRI appears to be permitted within a foundation's purposes, then the foundation and its advisors should determine whether IRC Section 501(c)(3) generally permits the PRI activity. One of the most well-established charitable purposes under Section 501(c)(3) is the "relief of the poor and distressed or the underprivileged". See Treasury Reg. Section 1.501(c)(3)-1(d)(2). In Revenue Ruling 74-587, 1974-2 C.B. 162, for example, the IRS approved as charitable an organization whose

Section 501(c)(3) – religious, charitable, scientific, literary, educational, national or international amateur sports, and prevention of cruelty to children or animals. Only "testing for public safety" appears in Section 501(c)(3) and not in Section 170(c)(2)(B).

²⁴ Treas. Regs. Section 53.4944-3(a)(2)(i).

mission was to stimulate economic development in “high density urban areas inhabited by low-income minority or other disadvantaged groups”. These areas lacked capital for development and suffered from a depressed economy. The IRS noted that local business owners had “limited entrepreneurial skills”. The charity sought to improve the area by providing low cost loans to local businesses.

In Private Letter Ruling 200325005, which is not precedential authority but provides a good insight into IRS thinking, the IRS found that the activity of empowering poor entrepreneurs in developing countries to start or expand their own businesses and to create additional job opportunities for the indigent was a valid charitable purpose. Here foreign “NGO’s use the funds [from the U.S.] to provide unsecured micro-enterprise loans and business training to needy persons, as well as support to support ongoing NGO activities...”

While each situation needs to be reviewed on its merits, it is clear that the IRS recognizes the relief of poverty through microfinance as a charitable activity.

b. “But for” sub-test. Satisfaction of this sub-test requires that analysis of the purpose of the investment permits the conclusion that it would not have been made but for its contribution to the accomplishment of the exempt purposes of the foundation.

2. *No Significant Investment Purpose Test.*

The single test here is whether *no significant purpose* of the investment is the production of income or the appreciation of property. The Regulations point out that the IRS will consider whether investors solely concerned with profit would be likely to make the investment on the same terms. However, the fact that an investment produces significant income or capital appreciation is not, in the absence of other factors, conclusive evidence that income or appreciation was a significant purpose of the investment,²⁵ and therefore does not preclude the investment from being a valid PRI.

The *no significant investment purpose* test is typically satisfied if a PRI is made in the form of a loan at below-market interest rates which are, by definition, unattractive to commercial lenders. Even a loan at market rates can pass muster if, for some other reason (such as high risk or inadequate security), the loan would not be made conventionally. Among the many private rulings issued by the IRS addressing this issue, acceptable annual interest rates for PRI loans have varied from 0 to 15%, usually below market but occasionally at market rates. Similarly, investment features designed to protect the investor’s interest or secure repayment

²⁵ Treas. Regs. Section 53.4944-3(a)(2)(iii).

have ranged from none at all (a willingness to convert loans into grants) to a full set of conventional mortgages and guarantees.²⁶

An investment in an entity having the dual purpose of both producing a return on investment and achieving a charitable purpose also may qualify as a PRI. In Private Letter Ruling 200136026, a private foundation proposed to invest in a for-profit corporation formed for the purpose of financing and promoting the expansion of environmentally-oriented businesses that would contribute to conservation and economic development in economically and/or environmentally sensitive areas. The corporation had dual goals of providing a rate of return for investors and demonstrating a clear environmental benefit through each investment. Only companies that met certain environmental guidelines were eligible for investment. The corporation also created an advisory committee, which included representatives of exempt public charities interested in preserving the environment, to scrutinize each investment. The foundation represented that the rate of return, taken by itself, would not compensate for the speculative nature of the investment and overall risk associated with the corporation's unique investment characteristics. The IRS determined that although the foundation expected a financial return, the investment was made directly to accomplish the foundation's charitable goals and thus qualified as a PRI.

Several other IRS private letter rulings have approved PRIs where non-charitable organizations were also investing on the same terms. In Private Letter Ruling 8710076, a \$10 million limited partnership was established with a taxable general partner, and limited partnership interests were offered to a small group of private foundations and private individuals. The purpose of creating the limited partnership was to go beyond informational services, to provide financial support to actual enterprises seeking to demonstrate that privatization of human services is a viable concept. A private foundation's \$600,000 investment in the partnership was approved by the IRS as a PRI.²⁷ PRI loans to for-profit limited partnerships are also a common mechanism for private foundations to support low-income housing and economic development in blighted areas.²⁸

3. *No Political Purpose Test.*

The Regulations set forth a requirement that *no purpose* of the PRI may be to attempt to influence legislation, or to participate or intervene in campaigns of

²⁶ See, e.g., PLR 8141025 (approval of secured low-income housing loans at 3% interest, with 20-year terms); PLR 8030079 (approval of urban renewal loan at 7% interest, with a 10-year term); PLR 8301110 (approval of secured loan for hotel construction in blighted area, charging 15% annual interest over 25 years).

²⁷ See also, PLR 9016078 (purchase of a large equity interest in a holding company affiliated with a for-profit enterprise, to develop business in a depressed area) and PLR 8807048 (investment in construction of low-income housing, accomplished through limited partnerships with for-profit corporations).

²⁸ See, e.g., PLRs 9112013, 8923070, 8923071 and 8637120.

candidates for public office.²⁹ There is an exception: the PRI recipient may appear before or communicate with a legislative body on a legislative matter of direct interest to the recipient, if the expense of doing so is deductible by the recipient under IRC Section 162.³⁰ However, the foundation must not earmark any PRI funds for use in such communications or appearances. The most common method of assuring compliance with this requirement is to obtain a statement from the recipient of the PRI funds pledging compliance with the IRS restriction on use of PRI funds for political purposes. Typically, one would find this statement in the PRI loan agreement, in the case of a loan or in the guarantee agreement (for MicroCredit Enterprises, see Philanthropic Guarantee Agreement in Chapter 11), in the case of a guarantee. It can be more difficult to find this type of statement in an equity investment.

Other Considerations and Obligations

In fulfilling its responsibilities and obligations under the law, a foundation making a PRI must address the following:

1. Changes in PRIs.

The Regulations, at Section 53.4944-3(a)(3)(i), address the possibility that after a PRI has been made, the foundation and the recipient may find that changes in the terms of the investment are needed. If the changes, like the original investment, are made primarily to further the investment's exempt purposes and not significantly to improve the prospects for income or capital appreciation from the PRI, the IRS sees no problem. Otherwise, changes may affect the loan's qualification as a PRI. In that case, reliance on a legal opinion based on circumstances before the change would no longer protect the foundation or its directors.

If a change is made *for the prudent protection of the foundation's investment*, then it will not *ordinarily* cause the investment to lose PRI status. This brings the *prudent person* standard back into the picture, but from a different direction. Under IRC Section 4944, a foundation is penalized if the management falls below this standard in its conventional investing. For PRIs, however, the foundation is permitted to rise to the level of the *prudent person* standard to protect its investment.

A *critical change in circumstances*, such as where the PRI turns out to be serving illegal purposes or private purposes of the foundation or its managers, will cause the investment to cease to be program-related. A foundation will not be penalized, however, if it terminates the PRI within thirty days after it or its managers have actual knowledge of the critical change in circumstances.

²⁹ Treas. Regs. Section 53.4944-3(a)(1)(iii).

³⁰ Treas. Regs. Sections 53.4944-3(a)(2)(iv) and 53.4945-2(a)(4) thus allow a business organization to use PRI funds for direct lobbying in certain circumstances.

2. Private Foundation Restrictions.

PRIs are affected by several other provisions of the IRC that govern private foundations generally.

Under IRC Section 4940, there is an annual 2% tax on a private foundation's net investment income. While capital gains on a PRI are not taxable, where the terms of the loan provide for the payment of interest, the 2% tax will apply to PRI interest income just as it does to a foundation's other investment income.

A PRI is a *qualifying distribution* for purposes of the requirement that private foundations make certain mandatory annual distributions, found in IRC Section 4942. The foundation will need to plan for appropriate accounting of PRIs under this Section, both when investments are made and also when they are repaid.³¹

A PRI is not included in the calculation of excess business holdings for purposes of IRC Section 4943.³²

Under IRC Sections 4942 and 4945, a foundation's administrative expenses incurred in connection with its PRIs receive favorable treatment. These expenditures are considered direct charitable expenditures not subject to penalty taxes. Section D below discusses Section 4945 expenditure responsibility requirements in greater detail.

If a private foundation makes a PRI to an organization that is not an exempt public charity, the foundation must exercise expenditure responsibility.³³

³¹ A court decision involving a PRI made by the Charles Stewart Mott Foundation upheld strictly the IRS requirement for complete reporting of PRIs on Form 990-PF. *Charles Stewart Mott Foundation v. United States*, 938 F.2d 58 (6th Cir. 1991).

³² Treas. Regs. Section 53.4943-10(b).

³³ That term refers to procedures that must be followed by the foundation before, at the time of, and after the making of the PRI, as follows: 1. Pre-grant Inquiry. The Regulations require private foundations to conduct the same kind of pre-grant inquiry for a PRI as for a grant to a non-charitable recipient. This is a limited inquiry, which must be complete enough to give a reasonable person assurance that the PRI will be used for the proper purposes. The inquiry should address the identity, prior history, and experience of the organization's managers, and consider any information the foundation has, or can readily obtain, concerning the management, activities, and practices of the recipient. 2. Written Contract. A foundation must enter into a written contract with the recipient of funds containing provisions specified in the Regulations. Therefore, every PRI made to a non-charity will require a separate agreement that meets this requirement. 3. IRS Reporting. The foundation must report each expenditure responsibility PRI to the IRS on Form 990-PF, in each year that it is outstanding, in a manner that satisfies the Regulations.

Legal Explanation - Frequently Asked Questions

How is a PRI different from a grant?

A grant represents an outright transfer of funds, either in one installment or more, to another organization or individual in furtherance of a foundation's exempt purpose. The foundation does not expect to have grant funds returned unless the grantee violates the terms of the grant agreement. A program related investment or "PRI," on the other hand, is an investment, typically a loan, a guarantee, or even an equity investment, which the foundation does expect to be returned, often with some minimal return on investment.

What are the legal requirements to make a PRI?

To make a PRI, a foundation must make three findings:

- The primary purpose of the PRI must be to accomplish one of the foundation's exempt purposes.
- The production of income or the appreciation of property may not be a significant purpose of the investment.
- No electioneering and only limited lobbying purposes may be served by the investment.

How does a foundation know if the primary purpose of the PRI is to accomplish one of its exempt purposes?

First, the PRI must be in furtherance of an exempt purpose that is recognized under IRC Section 501(c)(3). Where the recipient of a PRI loan or guarantee is a U.S. tax-exempt organization that is also a publicly supported charity, such as MicroCredit Enterprises, it is relatively easy for the foundation to determine that the purpose of the PRI is consistent with IRC Section 501(c)(3). This issue can be complex where the PRI recipient is not a United States, tax exempt public charity.

Second, the foundation must consult its own mission to make sure that the purpose of the PRI is consistent with the foundation's own charitable purposes. The foundation should consult its own organizing documents (or Form 990) to see if they contain any limitations on charitable purposes, and also consider whether any of its funds are otherwise restricted as to purpose. For example, if a foundation's stated mission is to promote the arts in California, it might not be able to make a PRI for economic development unless it were to formally amend its charitable purpose with the Internal Revenue Service. On the other hand, a foundation whose stated mission is

to reduce poverty in the United States and abroad might easily justify a PRI to foster economic development internationally as part of its overall commitment to poverty reduction.

Does the IRS recognize microfinance as a transaction that accomplishes an exempt purpose?

The IRS has recognized that microfinance can be a valid tool to accomplish the charitable purpose of alleviating poverty. Where the PRI recipient is contractually obligated to make loans only to microfinance institutions, the PRI recipient is furthering a 501(c)(3) charitable purpose. Moreover, where a PRI is made to a U.S. 501(c)(3), Section 509(a)(1) public charity like MicroCredit Enterprises, the foundation can be even more comfortable relying on that charity's representation that the PRI is consistent with its own exempt purpose because the charity, unlike a for-profit recipient, is itself limited in what it can do under IRC Section 501(c)(3).

How does the foundation determine if the production of income or the appreciation of property may not be a significant purpose of the investment?

This is a question of fact. A loan to a charity at an interest rate that is significantly below market is usually sufficient evidence of lack of investment purpose. When considering what constitutes a "market rate of interest," it is important to look at comparable loans. For example, one would expect to receive a substantially higher interest rate for a high risk, venture capital investment than for a fully-secured bank loan. Also it is helpful where the recipient can show that commercial lenders have not expressed an interest in the investment. This is the case with MicroCredit Enterprises, which has sought and not found U.S. commercial sources of loans.

How does the foundation determine if no electioneering and only limited lobbying purposes may be served by the investment?

Generally, the PRI documents will limit the ability of the PRI recipient to use any of the funds for lobbying or political activity. The agreements that MicroCredit Enterprises uses clearly post these limits.

Are all foundations permitted to make a PRI?

Every foundation is legally permitted to make a PRI. For each PRI, the foundation needs to consider the three legal requirements for a PRI (described above) to determine whether a particular PRI is appropriate for the foundation.

Is every foundation permitted to make a PRI loan or guarantee to MicroCredit Enterprises?

Each foundation, in consultation with its advisors, needs to make this decision. As a general rule, as long as the foundation's own organizing documents do not prohibit it from engaging in activities that contribute to the relief of poverty, then the foundation should be able to make a guarantee or loan PRI to MicroCredit Enterprises. MicroCredit Enterprises is a tax-exempt charitable organization, and its micro-credit loans are at the heart of its exempt activity. All loans that it makes are for impoverished people. Interest rates are below market. MicroCredit Enterprises limits the ability of its borrowers to lobby or engage in political activity.

Does a foundation need IRS approval to do a PRI?

No. A foundation does not need prior IRS approval to make a PRI.

Does a foundation need a lawyer to advise in connection with a PRI?

A legal opinion is not required. However, a written, well-reasoned legal opinion can provide protection to foundation directors and officers. MicroCredit Enterprises recommends that every foundation consult its own legal counsel in making a PRI. MicroCredit Enterprises has prepared this Toolkit to assist the foundation's counsel.

What process does a foundation follow to enter into a PRI?

In order to make a PRI loan or guarantee, a foundation needs to:

- Obtain the approval of its own board of directors.
- Enter into appropriate agreements with the PRI recipient.
- Report the PRI on its Form 990-PF.

Model PRI documents that a foundation can use in making a PRI to MicroCredit Enterprises are included in this Toolkit.

Does a foundation need to exercise expenditure responsibility for a PRI to MicroCredit Enterprises?

No. Because MicroCredit Enterprises is a public charity described in Section 509(a)(1), a foundation does not need to exercise expenditure responsibility. If the PRI recipient is not a public charity, then it is necessary to exercise expenditure responsibility, which is explained in more detail in footnote 33.

Does a foundation need to be concerned about the Patriot Act or other rules related to international activities for a PRI to MicroCredit Enterprises?

No. When the foundation makes a PRI loan or guarantee to MicroCredit Enterprises, that foundation is only responsible for confirming that MicroCredit Enterprises is not on the published list of terrorist organizations. MicroCredit Enterprises, and not the foundation making the PRI, then becomes responsible for complying with the Patriot Act and other rules.

MicroCredit Enterprises is not on the list of organizations engaged in terrorist or inappropriate activities, nor are any of its officers, directors, employees, or volunteers. MicroCredit Enterprises does have a process in place, as well, to review the recipients of its international loans.

How does a foundation report a PRI on the foundation's tax return (Form 990-PF)?

The Form 990-PF asks whether a foundation has engaged in any PRIs during the year. Check the box "yes", and describe the PRI.

The information contained in this document was not intended to be used, and cannot be used by a foundation or other taxpayer for the purpose of avoiding penalties that may be imposed under federal tax law. Under IRS rules, a taxpayer may rely on legal advice to avoid penalties only if the advice is reflected in a more formal tax opinion that conforms to new IRS standards. The advice contained in this document was written, in part, in support of MicroCredit Enterprise's program related investment program. Each foundation considering a PRI in MicroCredit Enterprises should seek advice, based on the foundation's particular circumstances, from an independent tax advisor.



E N T E R P R I S E S

Chapter 5

Assessing the Social Mission

The principal rationale for a PRI in microfinance is alleviation of extreme poverty. Microfinance is neither new nor untested. As numerous news reports, scholarly analyses and world leaders attest, microfinance is an effective, sustainable approach to poverty alleviation in the developing world. But, different microfinance organizations presenting different PRI opportunities pursue distinctive anti-poverty missions using different microfinance strategies.

While all microfinance funds assess and monitor MFI financial creditworthiness, the following questions can help a foundation understand the efficacy of a particular program. For each question below, we indicate how MicroCredit Enterprises responds in connection with its own PRIs. The list is not exhaustive and is not intended to substitute for a foundation's own judgment about its strategic mission.

Does the PRI recipient target a specific level of poverty?

MicroCredit Enterprises Response: Sustainable economic development for families living in extreme poverty (\$1.00 per day or less) is the special focus of MicroCredit Enterprises which gives special consideration to microfinance programs that: (a) increase the number of poor clients served, (b) operate comprehensive social service programs, such as women's empowerment, health education or business training, and (c) lower interest rates to impoverished client-borrowers.

All microfinance organizations serve the poor, but microfinance programs can be further evaluated by their results and poverty objectives. For example, some microfinance programs, by design or de facto, reach clients at a higher level of poverty (say \$2.00/day or more) with individual, small business loans (juxtaposition to microcredit loans).

For a detailed description about MicroCredit Enterprises' due diligence process and criteria, lending policies and MFI loan application, see the For

Microfinance Institution page at the MicroCredit Enterprises website (www.MCEnterprises.org).

What is the profile of the MFIs targeted by the PRI recipient?

MicroCredit Enterprises Response: MicroCredit Enterprises concentrates its lending on MFIs that are underserved by both domestic and international financial markets. By way of background, approximately 220 MFIs are regulated, commercial & shareholder-owned; for the most part, these MFIs make larger loans (on average \$1200.00); these larger and more mature MFIs garner 82% of all foreign investment. The argument for focusing on these MFIs is that they are less risky and have greater capacity to reach larger numbers of the poor. On the other hand, analysts have expressed concern about an “investment bubble” caused from too much money flowing to top-tier MFIs.

In contrast, MicroCredit Enterprises focuses on creditworthy MFIs that are making smaller loans. These MFIs are most likely non-profits and have greater difficulty accessing financial markets than their (typically) commercial counterparts. To review the MicroCredit Enterprises Microfinance Institution Loan Portfolio, see the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

Does the PRI recipient have a client gender preference?

MicroCredit Enterprises Response: MicroCredit Enterprises prefers to make loans to microfinance institutions primarily targeting impoverished women without explicitly excluding male borrowers. While all microfinance programs serve women clients, MicroCredit Enterprises has a greater level of focus on women than many other microfinance funds. For the latest Accomplishments and Status Report about MicroCredit Enterprises, the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

MicroCredit Enterprises focuses on women client-borrowers for many reasons: One, for a number of social and economic reasons, women have a more reliable and higher loan repayment rate. Two, historically women have suffered from marketplace discrimination. Three, financially solvent women usually place a high priority on feeding, clothing and educating their children, a long-term anti-poverty metric. Four, women with financial independence are empowered to address community and household matters, such as talking with their sex partners about safe sex, sharing health knowledge, speaking out about village issues, etc.

Does the PRI recipient prefer to invest in microfinance institutions (MFIs) reaching rural, indigenous populations or MFIs operating in more urban areas?

MicroCredit Enterprises Response: MicroCredit Enterprises favors MFIs serving rural and mountainous areas where the most needy people often reside. Not infrequently, these client-borrowers do not speak the primary language of their country (instead, speaking an indigenous language) which further isolates them from both wider economic opportunities and governmental services.

Rural areas tend to be the most underserved because reaching rural areas typically entails higher operating expenses and requires specialized lending procedures and products for destitute entrepreneurs. Thus, while MFIs with a rural focus can be creditworthy, they also may be the victim of de facto redlining³⁴ if microfinance intermediaries or funds evaluate financial metrics only.

Does the PRI recipient invest in MFIs that also provide comprehensive social services, education and women's empowerment?

MicroCredit Enterprises Response: MicroCredit Enterprises gives special consideration to overseas microfinance programs that operate comprehensive social service programs, such as women's empowerment, health education and business training. Integrating microfinance with pro-poor social services and educational programs is salutary because an empowered, educated, healthy woman is indispensable to building and sustaining a healthy family as well as improving household economic performance.

Not all microfinance funds favor ancillary pro-poor programs in reviewing MFI loan applications. Thus, while MFIs with free social service and educational programs can be creditworthy, they may also be the victim of de facto redlining if microfinance intermediaries or funds evaluate financial metrics only.

What is the PRI recipient's policy concerning MFI interest rates charged to poor people?

MicroCredit Enterprises Response: MicroCredit Enterprises favors loans to MFIs that are lowering or holding interest rates steady for impoverished entrepreneurs. Interest rates charged to poor borrowers for unsecured microloans are a huge improvement over loan interest rates charged by predatory loan sharks. Further, local lenders often simply refuse to lend to

³⁴ Redlining is the discriminatory practice of denying or increasing the cost of services based on irrelevant criteria.

women at all. But MicroCredit Enterprises considers that MFI interest rates across the board are still too high, so – as a matter of organizational policy and commitment – MicroCredit Enterprises prefers loans to microfinance institutions that are holding interest rates steady or, better, lowering them.

MFI interest rates vary widely from region to region and oftentimes the MFIs most focused on reaching isolated poor populations need to charge comparatively higher interest rates. While an MFI must charge an interest rate sufficient to cover unavoidably high transaction costs associated with making many tiny loans, MicroCredit Enterprises considers lower interest rate charges, coupled with operational self-sufficiency, both evidence of good MFI management as well as an important pro-poor policy.

Not all microfinance intermediaries track end-user interest rates because they believe local market conditions should dictate local interest rates. In this view, high interest rates will attract increasing investment into microfinance, fostering the development of more MFIs and eventually competition will bring down interest rates for poor borrowers.

Does the PRI recipient incorporate policies that build local capacity and respect local leaders?

MicroCredit Enterprises Response: MicroCredit Enterprises believes local leaders can best decide local priorities and meet challenges for themselves, so MicroCredit Enterprises endeavors to make loans to MFIs with reliable management and accountable boards of directors who respond to local community needs. Loans do not typically contain restrictive covenants or intrusive supervision.

By comparison, some microfinance funds, especially funds providing equity investments, are more interventionist and prescriptive, including requesting board seats on local MFIs. When working well, this closer involvement can allow for a greater exchange of technical assistance.

What is the PRI recipient's geographic focus?

MicroCredit Enterprises Response: MicroCredit Enterprises has a globally diversified MFI loan portfolio. Global focus diversifies political, macro-economic and natural disaster risk. To review the MicroCredit Enterprises Microfinance Institution Loan Portfolio, see the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

Some microfinance funds have global diversification goals, but in reality tend to serve only one or two continents or regions. Others, as a policy decision, concentrate on a particular region to enhance investment focus, market

expertise and cultural awareness. Perhaps as a result, Latin American MFIs receive 60% of all private microfinance debt.

Is the PRI recipient a non-profit or for-profit microfinance organization?

MicroCredit Enterprises Response: MicroCredit Enterprises is a 501(c)(3) non-profit public charity. For a copy of MicroCredit Enterprises' Internal Revenue Service Status Approval Letter, see the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

MicroCredit Enterprises is not operated as a profit-seeking venture for the benefit of any individual or institution. Neither MicroCredit Enterprises nor its financial benefactors "profit" from loans to severely-impooverished women and families. Under the MicroCredit Enterprises model, one hundred percent (100%) of all PRI investments are applied to overseas microfinance loans.

By comparison, some microfinance funds are organized as for-profit ventures. Shareholders, investors, senior management and others derive a direct financial benefit from microloans to poor borrowers. Advocates of this approach argue that until microfinance generates a commercially attractive rate of return, insufficient capital will exist to meet the financial needs of the world's poor.

Is the PRI recipient itself operationally self-sustainable with low operating costs and reasonable management fees and salaries?

MicroCredit Enterprises Response: MicroCredit Enterprises' total annual administrative budget is less than three percent (3%) of total loans to microfinance institutions. MicroCredit Enterprises is primarily financed by the differential between the interest rate charged microfinance institutions and the interest rate which MicroCredit Enterprises itself pays to borrow capital. For a copy of MicroCredit Enterprises' Annual Budget, see the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

The overwhelming majority of senior MicroCredit Enterprises executives and professional service firms work on an entirely pro bono basis. With the exception of the Senior Vice President for MFI Portfolio Management (a paid staff position), the entire management team is composed of volunteers, ranging from the full-time CEO and COO/CFO to web service, legal services, public relations, capital development/fundraising activities, etc.

Does the PRI recipient promote innovation in social entrepreneurial business models?

MicroCredit Enterprises Response: MicroCredit Enterprises promotes innovation in social entrepreneurial business models in three ways: One, MicroCredit Enterprises

is a transparent, open source organization. Thus, if a foundation has grant or PRI recipients working to alleviate poverty in any capacity, they are welcome to reproduce, use and distribute the contents of MicroCredit Enterprises financial model, legal documents, website and this booklet, provided they do so for a noncommercial, not-for-profit and educational purpose. MCE does not claim any copyright on its workproducts.

Two, MicroCredit Enterprises openly shares overseas MFI loan applications with other microfinance funds, so-called “competitors.” Similarly, MicroCredit Enterprises accepts loan applications from all qualified MFIs regardless of network affiliation and collaborates with other microfinance funds in making MFI loans.

Three, as mentioned, MicroCredit Enterprises relies almost entirely on pro bono senior management. In addition, MicroCredit Enterprises does not operate a “bricks and mortar” office, but instead functions as a “virtual” company. For example, the full-time (pro bono) CEO works from his home in California, the full-time (pro bono) COO/CFO works from his home in Oregon, the part-time (pro bono) General Counsel works from his law office in Washington, DC, and so on.

Is the PRI recipient affiliated with a specific microfinance network or operated as subsidiary or “sister organization” of another microfinance organization?

MicroCredit Enterprises Response: MicroCredit Enterprises is independent and unaligned with any particular microfinance organization, government agency or other institution. This independence assures both objectivity when conducting MFI due diligence and responsiveness to MFI clients.

Some microfinance networks operate microfinance funds as subsidiaries or sister organizations. Typically, but not always, these microfinance funds provide equity or loans exclusively or primarily to MFIs in their own network. A foundation will want to review the financial pros and cons of PRI investing with a microfinance network-operated fund. Microfinance network-operated funds work closely over a long period of time with their MFIs and, thus, are in a position to conduct more intensive due diligence. On the other hand, for the very same reason, investment objectivity may be compromised, potentially creating moral hazard for the microfinance network and potentially greater risk for the PRI-maker.

Is the PRI recipient affiliated with a religious or spiritual organization?

MicroCredit Enterprises Response: MicroCredit Enterprises is not affiliated or associated in any way with a religious or spiritual organization, but neither does MicroCredit Enterprises discriminate against creditworthy MFIs that are or have been associated with a religious institution. In approving loans to creditworthy MFIs, the sole standard is effective poverty reduction.

Additionally, MicroCredit Enterprises appreciates that respecting the people we help includes respecting local religious practices. Many faith-affiliated microfinance programs are operating much-needed and very successful microcredit and anti-poverty programs. For the foundation PRI-maker, this is a matter of policy preference.



E N T E R P R I S E S

Chapter 6

Conducting Financial Due Diligence

Like any commercial lender or investor evaluating a potential investment, a foundation should assess the financial viability of the PRI recipient. A foundation can, and indeed must, elect to factor in mission-related considerations in determining whether or not to make a PRI, but a baseline set of organizational, business and financial issues also warrants investigation.

This section of the Toolkit reviews basic financial due diligence topics. Each due diligence topic is followed by an illustrative response utilizing MicroCredit Enterprises as a case study. Different microfinance organizations and, thus, different PRI opportunities, offer different levels of risk, return and social mission focus.

The list that follows is not exhaustive and is not intended as a substitute for a foundation's own judgment about financial risk tolerance. In the end, the foundation will accept some normal investment risk in order to realize a financial rate of return (as it does with any investment) and, in the case of a PRI, simultaneously advance its public mission.

Will the PRI recipient use the funds invested for an income-generating purpose? If not, how will the PRI funds be used and how is the PRI recipient expected to repay the PRI?

MicroCredit Enterprises Response: MicroCredit Enterprises uses its PRI loans solely to make affordable loans to overseas microfinance institutions which, in turn, make microloans to impoverished borrowers. Microfinance is an "asset class" that, when implemented by well-managed microfinance institutions, has generated consistent performance. Worldwide the repayment rate is 97% by client-borrowers.³⁵

³⁵ By comparison, U.S credit card companies experience a 5% default rate (Wall Street Journal, May 15, 2007).

Thus, normally the PRI will be repaid from MicroCredit Enterprises overseas loan portfolio. Because MicroCredit Enterprises' lending criteria, portfolio diversification and due diligence standards for overseas loans are well-designed, MicroCredit Enterprises has experienced, to date, no loan defaults.³⁶

MicroCredit Enterprises loan portfolio is diversified on 4 continents. The maximum single microfinance institutional loan issued by MicroCredit Enterprises does not exceed \$1 million or 10% of the total loan portfolio. To review the MicroCredit Enterprises Microfinance Institution Loan Portfolio, see the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

In the event the PRI recipient is for any reason unable to repay the PRI, what collateral or other recovery mechanisms are in place to assure the foundation's investment is repaid?

MicroCredit Enterprises Response: In the unlikely event of an overseas microfinance institution default, the foundation qua lender has full recourse guarantees posted by Guarantors assigned to its loan. The security-to-loan value coverage ratio is 10:6. By under-leveraging the Guarantors' guarantees, MicroCredit Enterprises operates far from the financial edge.

In addition, it is MicroCredit Enterprises' responsibility to recoup from the Guarantors any default losses incurred. Each Guarantor shares the overseas loan default on a pro rata basis, significantly mitigating the risk exposure. Even a loan default of \$1 million produces a relatively small, after-tax net loss for high net worth individuals or foundations securing lines of credit. Each new Guarantor instantaneously further strengthens MicroCredit Enterprises' repayment capacity. For a roster of Guarantors, see Council of Guarantors at the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

Is the PRI recipient operationally self-sufficient or is it primarily dependent on episodic, charitable donations? Does the PRI recipient have financial projections that demonstrate operational self-sufficiency or the ability to achieve operational self-sufficiency during the PRI investment period?

MicroCredit Enterprises Response: MicroCredit Enterprises is operationally self-sufficient. MicroCredit Enterprises is primarily financed by the differential between the interest rate charged microfinance institutions and the interest rate which MicroCredit Enterprises itself pays to borrow capital (in this instance, a PRI loan). The organization also accepts charitable contributions and in-kind professional services.

³⁶ MicroCredit Enterprises issued its first loan to an MFI on January 1, 2006.

What percentage of the organization’s budget applies to administrative overhead, fundraising and other non-programmatic purposes? What is the PRI recipient’s annual budget?

MicroCredit Enterprises Response: MicroCredit Enterprises’ Annual Budget is approximately \$300,000. In 2007, the total organizational budget is under three percent (3%) of lendable funds for microloans. For a copy of MicroCredit Enterprises’ Annual Budget, see the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

The great majority of the management of MicroCredit Enterprises provides their services on a pro bono basis, so the maximum benefit from each dollar of support reaches the impoverished. The commitment of skilled professionals is saving literally hundreds of thousands of dollars and making this venture into a working reality. In addition, MicroCredit Enterprises does not operate a "bricks and mortar" office.

Does the PRI recipient’s leadership have the business skills to manage the organization and the foundation’s PRI? Do senior management and the board of directors possess a mix of business and executive skills (as well as mission-related skills)?

MicroCredit Enterprises Response: MicroCredit Enterprises does not treat non-profit tax status as an excuse for a lax management style. The majority of the MicroCredit Enterprises senior management and board of directors are drawn from the business world. For the biographies of senior management and the board of directors, see the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.

What are the PRI recipient’s current debt obligations, including the following information for each debt obligation: (a) Lender; (b) Original loan amount and disbursement date; (c) Outstanding balance; (d) Frequency of payments; (e) Final repayment date; (f) Interest rate (fixed or variable)?

MicroCredit Enterprises Response: MicroCredit Enterprises currently maintains loans from three lenders: Calvert Social Investment Foundation, the MSST Foundation and Tokyo Star Bank. Additional details available upon request.

Does the PRI recipient have a liquidity account or cash reserve to cover emergencies?

MicroCredit Enterprises Response: MicroCredit Enterprises maintains a liquidity fund called the HunterDouglas Endowment for Microfinance Sustainability. The Endowment is available to provide “bridge financing” or a “safety-net” to respond to unexpected financial emergencies in the overseas

loan portfolio and to cover short-term and temporary delays in payments from Guarantors. To date, there has been no reason to utilize the Endowment. Monies expended from the Endowment are reimbursed either by the overseas microfinance institutional borrower or by a permanent call on Guarantors. The Endowment is currently funded at \$1 million.

Does the PRI recipient have independently audited financial statements and year-to-date unaudited financial statements?

MicroCredit Enterprises Response: MicroCredit Enterprises is audited annually by the RINA Accountancy Corporation and the independent audit is publicly posted at the MicroCredit Enterprises website.

What are the PRI recipient's policies and procedures for internal controls to prevent financial fraud?

MicroCredit Enterprises Response: MicroCredit Enterprises employs standard accounting controls to guard against internal fraud or malfeasance. In addition, MicroCredit Enterprises is audited annually by the RINA Accountancy Corporation. For a copy of the latest independent audit, see the MicroCredit Enterprises web site (www.MCEnterprises.org) under Resource Documents.



E N T E R P R I S E S

Chapter 7

Gauging the Administrative Workload

In addition to assessing whether a PRI is furthering the social mission of the foundation (Chapter 5) and whether the PRI recipient is financially sound (Chapter 6), it is useful to consider any additional administrative workload a PRI might place on the PRI maker.

Here follows a series of basic administrative or organizational due diligence topics. Each due diligence topic is followed by an illustrative response utilizing MicroCredit Enterprises as a case study.

The list is not exhaustive and is not intended as a substitute for a foundation's own judgment. In the end, the foundation will accept some normal increased workload in order to realize a financial rate of return and, in the case of a PRI, simultaneously advance its public mission.

Will the PRI generate significantly more administrative work and costs for the foundation?

MicroCredit Enterprises Response: MicroCredit Enterprises provides administrative, legal and accounting support for its PRIs, thus keeping paperwork to a minimum. Indeed, this Toolkit supplies the necessary legal documents for a foundation to make a PRI to MicroCredit Enterprises. And, as provided in the model PRI legal documents, MicroCredit Enterprises will provide regular and reliable reports to the PRI maker.

Nevertheless, "PRI programs do require some increased costs, primarily in the areas of legal expenses, accounting expenses and additional staff time. However, when compared with the leveraging effect that PRIs can have, these costs can be relatively small. In addition, because PRIs are generally larger than grants, the cost per dollar of charitable activity may be the same

or lower than that of grantmaking. And, again, these PRI expenses count as direct charitable expenditures for federal income tax purposes.”³⁷

Does the PRI recipient engage in political activity that might endanger the validity of the PRI or require the foundation to monitor the PRI recipient?

MicroCredit Enterprises Response: MicroCredit Enterprises does not engage in any political or governmentally-related activities at all. In this regard MicroCredit Enterprises is like most microfinance intermediaries or funds, but since a “PRI cannot be made with the intent of influencing legislation or participating in a political campaign, just as a foundation may not make grants for this purpose,”³⁸ this is an important due diligence item to assess.

Will the PRI cause the foundation’s financial performance to suffer?

MicroCredit Enterprises Response: MicroCredit Enterprises offers two PRI opportunities. Under the Guarantor PRI, the foundation maintains complete control of its assets, thus receiving all investment returns from its portfolio. Under the loan PRI, the foundation realizes a rate of return for a fully-secured loan (typically equivalent to the U.S. Treasury Bill rate).

“Even though PRIs are investments, they do not belong in the same portfolio with regular foundation investments. They should be accounted for in separate portfolios and in separate accounts on the foundation’s balance sheets – each with its own measure of performance. PRI programs always require balancing the relationship between financial return and social return.....Outstanding PRIs are not counted as part of the foundation’s asset base when calculating the distribution requirement for private foundations.”³⁹

Will making a microfinance-related PRI increase foundation reporting requirements to the IRS or otherwise create more work for staff or trustees?

MicroCredit Enterprises Response: MicroCredit Enterprises offers two PRI opportunities, both of which are easy to administer and in full compliance with federal law. “The tax laws governing foundations make it relatively simple to make a PRI. The paperwork is not particularly burdensome. Only common-sense precautionary measures are required to assure conformity with the IRS regulations.”⁴⁰

³⁷ Piton Foundation staff and Brody & Weiser, Program Related Investment Primer, Council on Foundations, 1993.

³⁸ Ibid.

³⁹ Ibid.

⁴⁰ Ibid.

Chapter 8

PRI Loans to MicroCredit Enterprises

Legal and Tax Issues Overview

with Frequently Asked Questions

MicroCredit Enterprises accepts PRI loans from private foundations. While the specific interest rate, amount and term of each loan are a matter for discussion between MicroCredit Enterprises and each foundation, the general terms of the loans are described as follows:

A foundation can provide an interest-bearing *secured* revolving line of credit. Each \$1.2 million loan (the minimum required) supports up to 12,000 microcredit business loans. MicroCredit Enterprises secures the line of credit with full recourse pledges and/or collateral assets (10:6 collateral-to-loan coverage) provided by high net worth individuals and institutions (including other foundations). MicroCredit Enterprises seeks the most affordable loan terms commensurate with a foundation's risk profile since ultimately MicroCredit Enterprises' cost of borrowing is borne by poor women entrepreneurs in the developing world.

In order to make a PRI loan to MicroCredit Enterprises, a private foundation will need to enter into a loan agreement with MicroCredit Enterprises, and it will need to receive a promissory note from MicroCredit Enterprises. The loan agreement sets forth the basic terms of the loan and describes the guarantees. The promissory note is a negotiable instrument, much like a check, that can be taken to court and collected upon if MicroCredit Enterprises defaults.

MicroCredit Enterprises will work with each foundation to craft an appropriate loan agreement and promissory note. Often these two documents are prepared by the PRI-making foundation. In the event that a foundation does not already have these documents, MicroCredit enterprises offers a sample loan agreement and

⁴¹ Ibid.

promissory note that each foundation is free to use if it so chooses. These two documents appear in the next Chapter.

PRI Loan - Frequently Asked Questions

The following frequently asked questions are designed to respond to questions that foundations may have about PRIs loans being offered by MicroCredit Enterprises. For more general questions on program related investments see Chapter 4.

Is a loan to MicroCredit Enterprises a valid type of PRI?

Yes. Loans are well-recognized as an appropriate form of a program related investment. Several examples in the Treasury Regulations to Section 4944 describe loans, as do countless IRS rulings. Although a loan to MicroCredit Enterprises can be a valid PRI, each foundation still needs to consult its own advisors before making a PRI.

How does a foundation make a PRI loan?

PRI loans typically involve a loan agreement between the foundation and MicroCredit Enterprises and a promissory note from MicroCredit Enterprises to the foundation. In addition, the Board of Directors of the foundation should consider and approve the PRI. The PRI is then reported on the foundation's regular annual tax return.

Does a PRI loan count as a qualifying distribution under IRC Section 4942?

Yes. A PRI loan counts as a qualifying distribution at the time that the loan funds are paid from the foundation to the PRI recipient. This means that the amount of the loan counts towards the foundation's five percent (5%) annual payout obligation. When the loan is repaid, however, the principal amount of the loan adds back to the foundation's payout obligation in the year repaid. As an example, if a foundation holds assets for investment in the amount of \$20 million, it would have an annual payout amount of about \$1 million (5% of \$20 million). If the foundation makes a \$1 million PRI loan in 2007, it has satisfied its payout obligation for that year. If, in this example, the foundation is repaid the \$1 million in 2012, it will have its normal \$1 million payout obligation in 2012 plus an additional \$1 million obligation because of the returned loan. Of course, it can re-loan that \$1 million to satisfy this new obligation.

Is the interest on a PRI loan to MicroCredit Enterprises subject to tax?

Yes. Interest on a PRI loan to MicroCredit Enterprises is subject to the two percent (2%) tax on investment income pursuant to the IRC Section 4940.

Do we need to exercise expenditure responsibility for a PRI to MicroCredit Enterprises?

No. Because MicroCredit Enterprises is a 501(c)(3) public charity, a foundation does not need to exercise expenditure responsibility.

The information contained in this document was not intended to be used, and cannot be used by a foundation or other taxpayer for the purpose of avoiding penalties that may be imposed under federal tax law. Under IRS rules, a taxpayer may rely on legal advice to avoid penalties only if the advice is reflected in a more formal tax opinion that conforms to new IRS standards. The advice contained in this document was written, in part, in support of MicroCredit Enterprise's program related investment program. Each foundation considering a PRI in MicroCredit Enterprises should seek advice, based on the foundation's particular circumstances, from an independent tax advisor.



Chapter 9

Model PRI Loan Agreement

This Loan Agreement (the "Agreement") is entered into as of _____, 20__, between _____, a California nonprofit public benefit corporation, with offices at _____ (the "Lender") and MicroCredit Enterprises, a California nonprofit public benefit corporation, with offices at _____ (the "Borrower").

RECITALS

WHEREAS, the Borrower has applied to the Lender for a revolving line of credit loan in the amount of \$_____, with the proceeds thereof to be used by the Borrower for the purposes described in Section 1.4 of this Agreement, in furtherance of the exempt purposes of the Borrower described in Section 170(c)(2)(B) of the Internal Revenue Code of 1986, as amended (the "Code"); and

WHEREAS, the Lender is willing to make such loan to the Borrower upon the terms and subject to the conditions hereinafter set forth;

NOW, THEREFORE, in consideration of the foregoing premises, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

ARTICLE I

THE LOAN AND ITS PURPOSES

Section 1.1 The Line of Credit. The Lender agrees, subject to the terms and conditions hereinafter set forth, to offer a revolving line of credit to the Borrower, in the principal amount of _____ (\$_____) (the "Loan"). The closing of the Loan (the "Closing") shall be held on or before _____ (the "Closing Date") at the Lender's offices, or on such other date and at such other place as the parties may mutually agree. On the Closing Date and through the fifth anniversary of the Closing Date (the "Maturity Date"), the Borrower may request that the Lender make one or more advances ("Advances") to

Borrower by completing the Advance Request form attached as Exhibit B to this Agreement. Within ten days following the receipt of an Advance Request from Borrower, Lender shall fund the Advance by check, or as otherwise reasonably instructed by the Borrower. In no event shall Borrower request any single advance in an amount of less than fifty thousand dollars (\$50,000), and in no event shall the total of all outstanding Advances exceed the principal amount of the Loan, at any time. Borrower shall pay Lender interest at the rate of ___% on Advances that are outstanding from time to time, on the last day of each calendar quarter. Borrower shall repay all outstanding Advances on or before the Maturity Date.

Section 1.2 The Note and Guarantee. The Loan shall be evidenced by a promissory note of the Borrower (the "Note"), substantially in the form attached hereto as Exhibit A, duly executed on behalf of the Borrower by its authorized representatives and dated the Closing Date. All terms and conditions stated in the Note are hereby incorporated by reference in this Agreement. This Loan shall be guaranteed by ___ guarantees, each in the amount of \$_____, in the form of Exhibit C.

Section 1.3 Purpose of the Loan. Borrower's charitable purpose is to mobilize private capital to help finance microenterprise development in developing countries. Borrower makes (a) U.S. dollar-denominated loans to selected microfinance institutions overseas, which, in turn, directly lend the proceeds of such loans in local currency denominated loans to low-income entrepreneurs in developing countries, and (b) U.S. dollar-denominated loans to selected microfinance networks located in the U.S., which, in turn, make loans to affiliated and unaffiliated microfinance institutions overseas (each such loan, a "MicroCredit Loan"). To fund its MicroCredit Loans, Borrower obtains lines of credit and revolving loans from financial institutions, foundations and other lenders which are guaranteed by philanthropic guarantors. The sole purpose of the Loan is to further Borrower's MicroCredit Loan program described in this paragraph.

Section 1.4 Use of Proceeds. The Borrower shall use the proceeds of the Loan exclusively for the purposes set forth in Section 1.3.

ARTICLE II

REPRESENTATIONS AND WARRANTIES

The Borrower represents and warrants that:

Section 2.1 Organization and Powers. The Borrower is a nonprofit public benefit corporation duly formed, validly existing, and in good standing under the laws of the State of California. The Borrower has the power and authority to own its assets and properties and to carry on its activities as now conducted and as contemplated to be conducted. The Borrower has the power and authority to

execute, deliver and perform this Agreement, to execute and deliver the Note, and to borrow hereunder.

Section 2.2 Tax Status. The Borrower has received and maintains (a) a current and unrevoked determination of tax-exempt status under Section 501(c)(3) of the Code, and (b) a current and unrevoked ruling under Section 509(a)(1) of the Code that the Borrower is not a private foundation.

Section 2.3 Authorization; Binding Agreement. The execution, delivery and performance by the Borrower of this Agreement, the execution and delivery of the Note, and the borrowing hereunder, have been duly authorized by all requisite corporate action. Upon execution and delivery of each of them by the Borrower, this Agreement and the Note (the "Loan Documents") will constitute the legal, valid, and binding obligations of the Borrower, enforceable in accordance with their terms.

Section 2.4 Litigation. There is no action, suit, or proceeding pending or threatened before any court or governmental or administrative body or agency, nor is there any basis for any such action, that may reasonably be expected to result in a material adverse change in the activities, operations, assets, properties, or condition, financial or otherwise, of the Borrower, or to impair the ability of the Borrower to perform its obligations under the Loan Documents. The Borrower is not in violation of or alleged to be in violation of any judgment, writ, injunction, decree, rule, or regulation of any court or any governmental or administrative body or agency.

Section 2.5 No Conflicts. The execution, delivery and performance by the Borrower of the Loan Documents and the use of the Loan proceeds contemplated hereby will not violate any provision of law, any order, rule, regulation or judgment of any court or governmental or regulatory body, the Articles of Incorporation or Bylaws of the Borrower, or any indenture, agreement, instrument, or deed of trust to which the Borrower is a party or by which the Borrower or any of its assets or properties is bound, or conflict with, result in a breach of, or constitute (with due notice, lapse of time, or both) a default under any such indenture, agreement, instrument, or deed of trust, or result in the creation or imposition of any lien, charge, or encumbrance of any nature whatsoever upon any of the assets or properties of the Borrower, except as otherwise permitted, required, or contemplated by the Loan Documents. The Borrower is not a party to any indenture, agreement, or instrument, nor subject to any restriction, which adversely affects the ability of the Borrower to perform its obligations under the Loan Documents. The Borrower is not in default or alleged to be in default under any indenture, agreement, or instrument, for borrowed money, or under any indenture, agreement, or instrument which, if in default, might reasonably be expected to result in an adverse change in the activities, operations, assets, properties, or condition, financial or otherwise, of the Borrower, or to impair the ability of the Borrower to perform its obligations under the Loan Documents.

Section 2.6 Compliance with Government Regulation. The Borrower has obtained all necessary licenses, approvals, and authorizations from all appropriate governmental agencies, and is in compliance with all laws, rules, regulations, orders, writs, injunctions, or decrees, the violation of which would have a material adverse effect on the activities, operations, assets, properties, or condition, financial or otherwise, of the Borrower, or on the ability of the Borrower to perform its obligations under the Loan Documents.

Section 2.7 No Default. The Borrower is in compliance with all of the terms and provisions set forth in the Loan Documents on its part to be observed or performed, and no Event of Default (as defined in Article VI hereof), or any event that, with notice or lapse of time or both, would constitute any such Event of Default, has occurred and is continuing.

Section 2.8 Financial Condition. There has been no material adverse change in the Borrower's financial condition since the dates of the Borrower's most recent annual financial statements.

Section 2.9 Taxes. The Borrower has filed all tax and information returns required to be filed by Borrower in any jurisdiction, and has paid all taxes, assessments, fees, or other governmental charges which have become due and payable.

Section 2.10 Disqualified Persons. Neither the Borrower, nor any director, officer, or employee of the Borrower, is a "disqualified person" with respect to the Lender within the meaning of Section 4946(a) of the Code.

ARTICLE III

CLOSING CONDITIONS

The obligation of the Lender to make the Loan is subject to the following conditions precedent:

Section 3.1 Loan Documents. The Loan Documents shall have been duly executed as appropriate and delivered to the Lender and shall be in full force and effect.

Section 3.2 Closing Deliveries. On or before five (5) business days prior to the Closing Date, the Borrower shall have delivered to the Lender the following:

(a) certified corporate resolutions of the Borrower, signed by the President and the Secretary of the Borrower and in a form satisfactory to the Lender, regarding approval of the form, terms, and conditions of the Loan Documents by the Borrower's governing body, and the authorization of the Borrower's officers to sign and deliver this Agreement and the Note; and

(b) all such certificates of good standing and certified or other copies of the Articles of Incorporation and Bylaws of the Borrower, records of corporate proceedings of the Borrower, and such other documents, in form and substance satisfactory to the Lender, as the Lender may reasonably request.

Section 3.3 Representations and Warranties. On the Closing Date, the representations and warranties set forth in Article II of this Agreement shall be true and correct on and as of such date.

Section 3.4 Approval of Counsel for the Lender. On the Closing Date, all legal matters in connection with this Agreement and the transactions contemplated hereby shall be satisfactory to counsel for the Lender.

ARTICLE IV

AFFIRMATIVE COVENANTS

The Borrower covenants and agrees that so long as this Agreement shall remain in effect or the Note shall not have been repaid in full, and unless the Lender shall otherwise consent in writing in advance:

Section 4.1 Use of Proceeds. The Borrower shall use the proceeds of the Loan exclusively for the purposes set forth in Section 1.4, and on the terms, in the manner, and subject to the limitations set forth in the Loan Documents, and shall repay any portion of the Loan not used for such purposes.

Section 4.2 Existence and Properties. The Borrower shall do or cause to be done all things necessary to preserve, renew, and keep in full force and effect its corporate existence, privileges, licenses, permits, franchises and insurance coverage; comply with all laws and regulations applicable to it; and obtain and maintain in full force and effect all authorizations, consents, approvals, exemptions, franchises, permits, and licenses of, and filings with, governments or governmental or administrative bodies or agencies necessary for the performance of any act, the carrying on of any activity, or the entering into of any transaction by the Borrower.

Section 4.3 Payment of Indebtedness and Taxes. The Borrower shall pay all of its indebtedness and obligations promptly and in accordance with the terms thereof, file or cause to be filed all Federal, state, and local tax or information returns required to be filed by it, and pay and discharge or cause to be paid and discharged promptly any taxes, assessments, and governmental charges or levies imposed upon it or upon its income or profits, or upon any of its property or upon any part thereof, before the same shall become in default, as well as all lawful claims for labor, materials and supplies, or otherwise which, if unpaid, might become a lien or charge upon its property, or any part thereof; *provided, however*, that the Borrower shall not be required to pay and discharge or to cause to be paid

and discharged any such indebtedness, obligation, tax, assessment, charge, levy, or claim so long as the validity thereof shall be contested in good faith by appropriate proceedings and the Borrower shall have set aside on its books adequate reserves therefor.

Section 4.4 Tax Status. Borrower shall maintain its tax-exempt status and its non-private foundation status under Federal law, as set forth in Section 2.2 above, and shall maintain its tax-exempt status and nonprofit corporate status under state law.

Section 4.5 Financial Statements and Certificates of the Borrower. The Borrower shall furnish, or cause to be furnished, to the Lender:

4.5.1 As soon as available, but in no event later than the end of the ninth month after the end of each fiscal year of the Borrower, a balance sheet as of the end of such fiscal year, and the related statements of income and expenses and changes in financial position of the Borrower in a form acceptable to Lender.

Section 4.6 Reporting Requirements of the Borrower. The Borrower shall furnish or cause to be furnished to the Lender the following reports:

4.6.1 Within sixty (60) days after the end of each fiscal year of the Borrower and within sixty (60) days after the Loan has been repaid in full, a report of the Borrower, signed by its chief executive officer, evaluating the progress of the Borrower toward achieving the purposes described in Article I hereof, and the contribution of the Loan thereto; and

4.6.2 Such other information about the activities, business affairs, and financial condition of the Borrower as the Lender may from time to time reasonably request.

Section 4.7 Books and Records. The Borrower shall maintain books and records adequate to support the information specified in Sections 4.5 and 4.6 hereof, retain such books and records for a period of four years after repayment of the Loan, and make such books and records available at reasonable times for inspection by the Lender and its agents and representatives, with the assistance of Borrower's personnel as needed.

Section 4.8 Notice to the Lender. The Borrower shall advise the Lender in reasonable detail of the occurrence of any of the following events:

4.8.1 Any change in the positions or responsibilities held by the Borrower's key personnel, who shall be the officers elected by the Borrower's governing body, the Borrower's Chief Executive Officer and Chief Financial Officer, and the senior directors of the Borrower's program(s) funded by the Loan.

4.8.2 Any proceeding instituted or threatened against the Borrower in or before any court or any governmental or administrative body or agency, which proceeding could have a material adverse effect upon the operations, assets, or properties of the Borrower; or any investigation, adverse regulatory action, or proposed action by any governmental body or agency against the Borrower;

4.8.3 Any denial of or challenge to the tax-exempt status, non-private foundation status, or nonprofit corporate status of the Borrower by any governmental authority;

4.8.4 Any change in circumstances that would cause the Loan no longer to serve the purposes stated in Section 1.3 and 1.4 hereof;

4.8.5 Any material adverse change in the condition, financial or otherwise, or operations of the Borrower; and

4.8.6 Any Event of Default or other event that, with notice or lapse of time or both, would constitute an Event of Default.

ARTICLE V

NEGATIVE COVENANTS

The Borrower covenants and agrees that, until payment in full of the principal of the Loan, and unless the Lender shall otherwise consent in writing in advance (which consent shall not be unreasonably withheld):

Section 5.1 Legislative and Political Uses of Loan Proceeds. The Borrower shall not use any proceeds of the Loan for any of the purposes described in Section 170(c)(2)(D) of the Code, except as permitted by U.S. Treasury Regulations, as follows. The Borrower shall not use any proceeds of the Loan to carry on propaganda or otherwise to attempt to influence legislation (within the meaning of Section 4945(d)(1) of the Code), or to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of Section 4945(d)(2) of the Code); *provided, however*, that the Borrower may expend funds from the proceeds of the Loan to pay for appearances before, or communications to, a legislative body with respect to legislation or proposed legislation of direct interest to the Borrower, if, and only if, a tax deduction under Section 162 of the Code is then allowable to the Borrower for such expenditure. The Lender and the Borrower understand that no proceeds of the Loan are earmarked to be used for such appearances or communications.

Section 5.2 No Material Change. The Borrower shall not make any material change in the nature of its activities as presently conducted that would adversely affect the Borrower's ability to perform under the Loan Documents. Furthermore, Borrower shall not conduct its activities in a manner that materially

departs from the representations made in the documents submitted by Borrower to the Lender in connection with Borrower's request for this Loan.

Section 5.3 Acquisition of Business; Merger or Consolidation; Disposal of Assets. The Borrower shall not (a) acquire all or substantially all the assets or properties of any other entity, except by gift, bequest, or other donation, or pursuant to the enforcement of a loan or security interest; (b) sell, lease, transfer, or otherwise dispose of any substantial part of its assets or properties; or (c) dissolve, liquidate, merge, or consolidate with or into any other person, firm, corporation, or other business entity.

Section 5.4 Governing Document Amendments. The Borrower shall not amend its Articles of Incorporation or Bylaws in any manner that would cause the Borrower to be in violation of any provision of the Loan Documents or which would jeopardize the ability of the Borrower to perform its obligations under the Loan Documents.

Section 5.5 Future Indebtedness. Borrower shall not incur, create, assume, or suffer to exist any debt or obligation for borrowed money other than (a) the Loan, and (b) indebtedness incurred in the ordinary course of business that does not materially adversely affect the ability of the Borrower to perform any of its obligations under the Loan Documents.

ARTICLE VI

DEFAULT AND REMEDIES

Section 6.1 Events of Default. The Borrower shall be deemed to be in default under this Agreement upon the occurrence of any of the following events (each of which is herein sometimes called an "Event of Default"):

6.1.1 The Borrower fails to make any payment of principal or interest that is due and payable hereunder, and such default continues unremedied for fifteen (15) days after notice to the Borrower;

6.1.2 The Borrower uses any portion of the proceeds of the Loan for a purpose or in a manner other than specifically authorized by this Agreement;

6.1.3 Any material representation or warranty made in the Loan Documents, or in any report, certificate, financial statement, or instrument furnished in connection with this Agreement or the Loan, shall prove to have been false or misleading when made, in any material respect;

6.1.4 The Borrower violates or fails to observe or perform any covenant contained in Section 4.4 or Section 5.1 hereof;

6.1.5 The Borrower violates or fails to observe or perform any other covenant contained herein, or any agreement on the part of the Borrower to be observed or performed pursuant to the Loan Documents, other than those referred to above in this Section 6.1, and such default shall continue unremedied for thirty (30) days after notice to the Borrower;

6.1.6 The Borrower shall fail to pay when due, after the expiration of any applicable grace periods, any amounts owing to third parties in respect of obligations for borrowed money aggregating in excess of an amount equal to ten percent (10%) of the original principal balance of the Loan; or the party to whom any such indebtedness is owed shall have notified the Borrower of its intent to accelerate the repayment of such indebtedness;

6.1.7 A judgment or judgments for the payment of money aggregating an amount in excess of ten percent (10%) of the original principal balance of the Loan shall be rendered against the Borrower, and the same shall not have been discharged or bonded on appeal for a period of sixty (60) consecutive days, and during such time execution shall not have been effectively stayed;

6.1.8 Property of the Borrower with an aggregate value in excess of ten percent (10%) of the original principal balance of the Loan shall be attached, and such attachment or attachments shall not be discharged or bonded within sixty (60) days of the date thereof; or

6.1.9 The Borrower shall have an order for relief entered against it by a bankruptcy court; or admit in writing its inability to pay its debts as they mature; or make an assignment for the benefit of creditors; or apply for or consent to the appointment of any receiver, trustee, or similar officer for it or for all or any substantial part of its property; or suffer the appointment of such receiver, trustee, or similar officer, which appointment shall continue undischarged for a period of thirty (30) days; or institute (by petition, application, answer, consent, or otherwise) any bankruptcy, insolvency, reorganization, arrangement, readjustment of debt, dissolution, liquidation, or similar proceeding relating to the Borrower under the laws of any jurisdiction; or suffer the institution of any such proceeding (by petition, application, or otherwise) against the Borrower, which proceeding shall remain undischarged or unstayed for a period of thirty (30) days; or by any act indicate its consent to, approval of, or acquiescence in such proceeding or the appointment of any receiver or trustee for the Borrower or any substantial part of its property.

Section 6.2 Remedies. If an Event of Default occurs or is continuing:

6.2.1 At the option of the Lender, the Lender may, by written notice to the Borrower, declare the Note, and any and all other indebtedness of the Borrower to the Lender, immediately due and payable, whether or not the Note or the other indebtedness shall be otherwise due and payable and whether or not the Lender shall have initiated any other action for the collection of the Note; whereupon the

Note and such other indebtedness shall become due and payable, as to the principal, interest, and any other amounts payable, without presentment, demand, protest, or notice of any kind, all of which are hereby expressly waived by the Borrower.

6.2.2 In addition, the Lender may pursue any and all remedies available to it at law or in equity for the collection of the Note and enforcement of the provisions hereof.

ARTICLE VII

INDEMNIFICATION

The Borrower hereby indemnifies and agrees to defend and hold harmless the Lender, its directors, officers, employees, agents, and affiliates, from and against any and all losses, liability, damages, and expenses (including attorneys' fees and expenses) which any of them may incur or be obligated to pay in any action, claim, or proceeding against them or any of them, for or by reason of any acts, whether of omission or commission, that may be committed or omitted by the Borrower or any of its servants, agents, or employees, in connection with this Agreement. The provisions of this Article and the Borrowers' obligations hereunder shall survive any expiration, termination, or rescission of this Agreement. In the event that a judgment, levy, attachment, or other seizure is entered against the Lender arising from any claim within the scope of this indemnification, the Borrower shall promptly post any necessary bond to prevent execution against any property of the Lender.

ARTICLE VIII

MISCELLANEOUS

Section 8.1 Entire Agreement. This Agreement and the Exhibits attached hereto constitute the entire agreement between the parties with respect to the transactions contemplated hereby and supersede all prior agreements or understandings, written or oral, in respect hereof.

Section 8.2 Notices. Any notice or communication required or desired to be given hereunder by either of the parties to the other shall be in writing and delivered by hand, via facsimile transmission, or mailed by first class mail or by nationally-recognized overnight courier, postage prepaid (notices shall be deemed given three days after being duly mailed, or one day after being sent by overnight courier), addressed to the party at its address appearing below:

If to the Borrower, to:

Attention: _____
Phone: _____
Fax: _____

If to the Lender, to:

Attention: _____
Phone: _____
Fax: _____

With a copy to:

Attention: _____
Phone: _____
Fax: _____

Section 8.3 Waiver; Remedies. No waiver of any provision hereof shall be valid unless in writing signed by the party waiving its rights under the provision. No course of dealing or delay or failure on the part of either party in exercising any right, power, or privilege hereunder shall operate as a waiver thereof or otherwise prejudice such party's rights, powers, or remedies, nor shall any waiver in any particular instance of any right, power, or privilege hereunder on the part of either party operate as a waiver of such or any other right, power, or privilege hereunder in any other instance.

Section 8.4 Assignment. The Lender may assign all or any portion of its rights or obligations under the Loan Documents, and in the event of such assignment, the assignee shall be accorded the full rights of the Lender by the Borrower with respect to such assignment. The Borrower may not assign all or any portion of its rights or obligations under the Loan Documents without the prior written consent of the Lender.

Section 8.5 Headings. The headings in the Loan Documents are for convenience of reference only and shall not affect the meaning or interpretation of the Loan Documents.

Section 8.6 Counterparts. This Agreement may be executed in counterparts, each of which shall constitute an original, but all of which, when taken together, shall constitute only one agreement.

Section 8.7 Governing Law. The Loan Documents shall be governed by and construed in accordance with the laws of the State of California applicable to agreements made and to be performed entirely within such State.

Section 8.8 Severability. If any provision of the Loan Documents shall for any reason be held to be illegal, invalid, or unenforceable, such illegality shall not affect any other provision of the Loan Documents, but the Loan Documents shall be construed as if such illegal, invalid, or unenforceable provision had never been contained herein.

Section 8.9 Modification; Amendment. No change, modification or amendment of any provision hereof shall be valid unless in writing signed by the party to be bound.

Section 8.10 Other Parties. Nothing in the Loan Documents shall be construed as giving any person, firm, corporation, or other entity other than the parties any right, remedy, or claim under or in respect of the Loan Documents or any provision thereof.

Section 8.11 Attorneys' Fees and Costs. In the event of any controversy, claim, or dispute between the parties arising out of or relating to the Loan Documents, or the alleged breach thereof, the prevailing party shall, in addition to any other relief, be entitled to recover its reasonable attorneys' fees and costs of sustaining its position.

IN WITNESS WHEREOF, the parties' duly authorized representatives have signed this Agreement below.

LENDER:

By: _____

Typed Name: _____

Title: _____

BORROWER:

By: _____

Typed Name: _____

Title: _____

By: _____

Typed Name: _____

Title: _____

Exhibit A

Promissory Note

\$ _____
____ Percent (____%)

San Francisco, California
_____, 200__

MicroCredit Enterprises, a California nonprofit public benefit corporation (the "Borrower"), for value received, hereby promises to pay to the order of _____ (the "Lender"), or holder, at its offices at _____, or at such other place or places in the United States of America as the holder hereof may designate in writing from time to time, the Advances outstanding from time to time under the terms of the Loan Agreement ("Agreement") between Borrower and Lender, of even date herewith, with interest thereon at the rate of _____ percent (____%) per annum on the Advances and accrued interest thereon remaining unpaid from time to time, from the date hereof until such principal amount is fully repaid. The terms of interest payments shall be as set forth in the Agreement. The entire unpaid principal balance, together with all accrued but unpaid interest, shall be due and payable on the Maturity Date.

The Borrower may, without notice, prepay the Loan in whole or in part, without premium or penalty, at any time or from time to time, with accrued interest to the date of such prepayment, if any; *provided*, however, that each such prepayment shall be applied first to interest accrued but unpaid on the entire outstanding principal balance of the Note through the date of such prepayment, if any, and then to principal.

This Note is the Note referred to in the Agreement, and the holder hereof is entitled to the benefits of such Loan Agreement and may enforce the provisions thereof and exercise the remedies provided thereunder or otherwise available in respect thereof. Any defined term not defined herein shall have the meaning set forth in the Agreement. To the extent that the terms of the Note are in conflict with the Loan Agreement, the terms of the Agreement shall control.

Payments of principal and interest, if any, shall be made in lawful money of the United States of America. Whenever any payment to be made hereunder would otherwise be due on a Saturday, Sunday, or public holiday under the laws of the State of California, such payment shall be due on the next succeeding business day.

This Note shall be payable without presentment, demand, protest, or notice of any kind, all of which are unconditionally waived by the Borrower.

This Note shall be governed by and construed in accordance with the laws of the State of California.

By: _____

Typed Name: _____

Title: _____

By: _____

Typed Name: _____

Title: _____

Exhibit B

Form of Advance Request

This Advance Request is submitted in accordance with the Revolving Loan Agreement made as of August [___], 2006 (“**Loan Agreement**”) between _____, a 501(c)(3) exempt private foundation (“**Lender**”) and MicroCredit Enterprises, a California nonprofit public benefit corporation (“**Borrower**”).

Borrower hereby requests that an Advance be made under the Loan Agreement in the amount of \$[_____].

The undersigned hereby certifies to Lender that as of the date of this Advance Request the undersigned officer of Borrower is a duly appointed officer of Borrower and this Advance was duly authorized and approved by Borrower in accordance with Borrower’s Operating Agreement and its governing documents as in effect the date hereof.

All capitalized terms used by not defined herein have the meaning ascribed to such terms in the Loan Agreement.

Dated: _____, 200__

Microcredit Enterprises,

By: _____

Name: _____

Title: _____

Exhibit C

Form of Limited Guaranty

In consideration of loans by _____, a 501(c)(3) exempt private foundation ("Lender"), to MicroCredit Enterprises, a California nonprofit public benefit corporation ("Borrower"), under that certain Loan Agreement dated as of _____, 200__ (as amended from time to time, the "Agreement"), the undersigned guarantor ("Guarantor") unconditionally and irrevocably guarantees the following obligation of Borrower under the Agreement (such capitalized terms used herein, but not defined shall have the meaning set forth in the Agreement) (the "Guaranty"):

a. the prompt payment when due of all regularly scheduled principal and/or interest payments on all of the Advances in the amounts and at the times due and payable pursuant to the terms of the Agreement in effect on the date hereof, but not to exceed the sum of \$_____ (the "Guaranteed Obligations").

Guarantor further acknowledges that Lender would not have entered into the Agreement if Guarantor had not agreed to enter into this Guaranty.

1. If Borrower does not perform the Guaranteed Obligations, Guarantor will immediately perform the same. Guarantor shall not be responsible for any other obligations of Borrower under the Agreement.

2. These obligations are independent of Borrower's obligations and separate actions may be brought against Guarantor (whether action is brought against Borrower or whether Borrower is joined in the action).

3. Guarantor waives:

a. Any right to require Lender to (i) proceed against Borrower or any other person, or (ii) pursue any other remedy. Lender may exercise or not exercise any right or remedy it has against Borrower without affecting Guarantor's liability.

b. Any defenses from disability or other defense of Borrower or from the cessation of Borrower's liabilities.

c. Any defense from the loss of any right of reimbursement or subrogation or any other rights against Borrower. Until all of Borrower's obligations to Lender have been paid in full, Guarantor has no right of subrogation or reimbursement or subrogation or other rights against Borrower.

4. Any payments received by Lender (i) after the occurrence and during the continuation of an Event of Default, as defined in the Agreement, or (ii) after the amounts due under the Agreement have been accelerated, shall be applied by Lender to scheduled amounts under the Advances in reverse chronological order, and accordingly will not relieve Guarantor of the obligation to pay amounts currently becoming due until all of the Guaranteed Obligations are paid in full.

5. This Guaranty and all acts and transactions hereunder and all rights and obligations of Lender and Guarantor shall be governed by the laws of the State of California.

6. If any other Person in addition to Guarantor shall guarantee the payment of all or any part of Borrower's Obligations, all guarantors and their respective successors and assigns shall be jointly and severally bound by the terms of this Guaranty and any other guaranty of Borrower's Obligations, notwithstanding any relationship or contract of co-obligation by or among such guarantors.

7. This Guaranty shall be binding upon and inure to the benefit of Guarantor and Borrower and their respective successors and assigns, except that Guarantor shall not have the right to assign its rights hereunder or any interest herein without the prior written consent of Borrower, which may be granted or withheld in Borrower's sole discretion. Any such purported assignment by Guarantor without Borrower's written consent shall be void.

8. This Guaranty may not be waived, revoked or amended without Lender's prior written consent. If any provision of this Guaranty is unenforceable, all other provisions remain effective. This Guaranty is the entire agreement among the parties about this guaranty. No prior dealings, no usage of trade, and no parol or extrinsic evidence may supplement or vary this Guaranty. This Guaranty benefits Lender. This Guaranty is in addition to any other guaranties Lender obtains.

Date: _____, 200__

[Insert Guarantor's name]

Chapter 10

PRI Guarantor to MicroCredit Enterprises

Legal and Tax Issues Overview

with Frequently Asked Questions

MicroCredit Enterprises accepts program related guarantees from private foundations. While specific PRI loans can be negotiated, it is important that the guarantees, which provide security for the loans, are uniform. The basic terms are as follows:

A foundation can guarantee the PRI loans made by other foundations, individuals, and businesses to MicroCredit Enterprises. Each \$1 million guarantee (the minimum required) supports up to 5,000 microcredit business loans. The foundation maintains complete control of its assets, thus receiving all investment returns from its portfolio, but does not realize a return on the guarantee risk. In the event of an overseas financial loss, each guarantor bears the loss on an equitable, pro rata basis with all other guarantors.

In order to make a PRI guarantee to MicroCredit Enterprises, a private foundation will need to enter into a guarantee agreement with MicroCredit Enterprises. The guarantee agreement sets forth the basic terms of the guarantee and appears in the next Chapter.

PRI Guarantor - Frequently Asked Questions

The following frequently asked questions are specific to PRI guarantees in MicroCredit Enterprises. For more general questions on program related investments see Chapter 4.

Is a guarantee to MicroCredit Enterprises a valid type of PRI?

Yes. A guarantee to MicroCredit Enterprises is a valid form of program related investment. Each foundation must still discuss with its own tax

advisor whether it is permitted to make a PRI guarantee to MicroCredit Enterprises.

How does a foundation make a PRI guarantee?

A PRI guarantee typically involves an agreement between the foundation and MicroCredit Enterprises. In addition, the Board of Directors of the foundation should consider and approve the PRI. The PRI is then reported on the foundation's tax return. Forms for such agreements are set forth in Chapter 13.

Does a PRI guarantee count as a qualifying distribution pursuant to IRC Section 4942?

No. A PRI guarantee will not count as a qualifying distribution unless the guarantor is actually required to transfer funds to MicroCredit Enterprises under the guarantee. At that time, the payment will be a qualifying distribution.

Does a foundation need to exercise expenditure responsibility for a PRI to MicroCredit Enterprises?

No. Because MicroCredit Enterprises is a 509(a)(1) public charity, a foundation does not need to exercise expenditure responsibility. If the PRI recipient is not a public charity, then it is necessary to exercise expenditure responsibility, which is explained in more detail at Chapter 4, addressing legal consequences.

The information contained in this document was not intended to be used, and cannot be used by a foundation or other taxpayer for the purpose of avoiding penalties that may be imposed under federal tax law. Under IRS rules, a taxpayer may rely on legal advice to avoid penalties only if the advice is reflected in a more formal tax opinion that conforms to new IRS standards. The advice contained in this document was written, in part, in support of MicroCredit Enterprise's program related investment program. Each foundation considering a PRI in MicroCredit Enterprises should seek advice, based on the foundation's particular circumstances, from an independent tax advisor.



Chapter 11

Philanthropic Guarantee Agreement

THIS PHILANTHROPIC GUARANTEE AGREEMENT (including all Attachments hereto, collectively, this "**Agreement**") is made on this ___ day of _____, 200_ by and between MicroCredit Enterprises, Inc, a California non-profit corporation ("**MCE**") and

FOR INDIVIDUAL:

_____, a natural person having his/her principal residence at _____,

FOR ENTITY:

_____, a _____ having its principal place of business at _____ ("**Guarantor**").

RECITALS

WHEREAS, MCE is an entity whose purpose is to leverage private capital to help finance micro-businesses of impoverished entrepreneurs in the developing world;

WHEREAS, MCE's philanthropic intentions and operating model are more particularly described in that certain Comprehensive Informational Memorandum, which may be changed, updated and supplemented from time to time by MCE (as changed, updated and supplemented, the "**Information Memorandum**");

WHEREAS, MCE makes loans (a) directly to selected microfinance institutions overseas and (b) to selected microfinance networks located in the United States which in turn make loans to affiliated and unaffiliated microfinance institutions overseas, and in each case the microfinance institutions overseas in turn

directly lend the proceeds of such loans in local currency denominated individual loans to entrepreneurs in developing countries (each such loan in clause (a) and (b) above, as more particularly described in the Information Memorandum, a "**Microcredit Loan**");

WHEREAS, prospective Microcredit Loans are evaluated by a loan committee, a majority of the members of which are guarantors in the philanthropic guarantee program, established by MCE for such purpose (the "**Loan Committee**");

WHEREAS, the Loan Committee recommends making and not making prospective Microcredit Loans from time to time based upon underwriting standards and parameters adopted and as modified from time to time in the sole discretion of the Loan Committee;

WHEREAS, to fund its Microcredit Loans, MCE obtains lines of credit, term loans and revolving loans from financial institutions, foundations, other lenders and Guarantor Lenders (as defined below) (each such loan, a "**Guaranteed Loan**"), each of which is in effect supported by all of the guarantors who have entered into agreements with MCE similar to this Agreement pursuant to which they have joined MCE's Risk Pool (as defined in Section 4.2) and some of which are also directly guaranteed by one or more guarantors;

WHEREAS, to induce MCE to enter into this Agreement and to induce a lender to make a Guaranteed Loan to MCE, Guarantor agrees to be placed into a Guarantor Category and to the agreements associated with such Guarantor Category in support of its commitments under this Agreement;

WHEREAS, MCE uses the proceeds of the Guaranteed Loans to fund the Microcredit Loans;

WHEREAS, to the extent MCE suffers losses on a particular Microcredit Loan, such losses shall be borne *pro rata* among all Guarantors in MCE's Risk Pool at such time;

WHEREAS, MCE shall be responsible for allocating any such losses in accordance with the terms of this Agreement, including the "Standard of Care" set forth herein; and

WHEREAS, MCE has obtained a ruling affording federal tax-exempt status under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended; and

WHEREAS, Guarantor desires to support MCE's philanthropic guarantee program and its Microcredit Loans and to join the Risk Pool in accordance with the terms set forth in this Agreement.

[For PRI Guarantor -- **WHEREAS**, Guarantor is a tax-exempt private foundation that has determined that supporting MCE through a guarantee furthers its charitable mission and constitutes a program related investment.]

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing premises and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto hereby agree:

ARTICLE 1

PARTICIPATION

Section 1.1. Participation. Guarantor hereby agrees to participate, and MCE hereby accepts Guarantor's participation, as a guarantor in MCE's philanthropic guarantee program upon the terms set forth in this Agreement. Notwithstanding any provision in this agreement or the documents executed by the Guarantor in connection herewith or related hereto, Guarantor's maximum commitment and obligation to the program shall not exceed \$1,000,000.00 for any reason or under any circumstances.

Section 1.2. Guaranteed Loan. Guarantor and MCE acknowledge and agree that, in reliance upon Guarantor's commitments under this Agreement, MCE intends to borrow an amount not to exceed \$600,000.00 per Guarantor from one or more lenders (each, a "**Lender**") pursuant to a separate agreement to be entered into between MCE and such Lender (which such loan(s) shall constitute a Guaranteed Loan and is referred to in this Agreement as such).

Section 1.3. Full Recourse Guarantee. Guarantor agrees that its obligations hereunder and under any Guaranteed Loan are full recourse to Guarantor and any Lender shall not be limited in recourse to any particular assets of Guarantor that may be pledged to such Lender in support of the guarantee; provided, however, that in no event shall Guarantor be liable to any Lender for an amount in excess of \$1 million.

Section 1.4 Term of Commitment to Program.

Section 1.4.1. Withdrawal Date. Guarantor hereby agrees that it shall remain in MCE's philanthropic guarantee program until it provides advance written notice to MCE of its desired withdrawal. After eighteen (18) months following such notice date, Guarantor may withdraw its commitment to the program.

Section 1.4.2. Effect of Withdrawal. If deemed appropriate or necessary by MCE in connection with the withdrawal, a *pro rata* portion of MCE's outstanding borrowings, and borrowing availability, corresponding to Guarantor's

participation may be required to be fully repaid, including all interest and expenses associated therewith. As part of the withdrawal, both MCE and Guarantor shall have received a full and complete release and termination of the documentation related to Guarantor's guarantee to a Lender, including in the case of a Signatory Guarantor or a Collateral Guarantor a reduction in the promissory note and Guarantee and any associated Pledge and Security Agreement and any other security interest and perfection documents related to any collateral pledged in support thereof, as applicable, subject to the survival for a customary period of any customary representations, warranties and indemnities with respect thereto.

ARTICLE 2

GUARANTOR CATEGORIES

Section 2.1. Guarantor Category. With respect to its participation, Guarantor hereby selects one of the two Guarantor Categories checked below, and makes the representations and warranties, and agrees to the covenants, associated with such Guarantor Category both below and on the applicable Appendix.

- Signatory Guarantor.** By selecting this Guarantor Category, Guarantor hereby represents, warrants and covenants that all of the following are true as of the date of this Agreement and shall remain true during the term of this Agreement and any extensions or renewals thereof:
 - Guarantor's net worth is in excess of \$15 million;
 - Guarantor has an amount in excess of \$1 million not subject to any encumbrances or restrictions and readily available to be funded to MCE or a Lender upon not more than three Business Days' notice; and
 - Guarantor has all necessary authority and agrees to take all steps and execute and deliver all necessary documentation contemplated by Attachment A.

- Collateral Guarantor.** By selecting this Guarantor Category, Guarantor hereby grants a first priority security interest in pledged Collateral as described on Attachment B to MCE and a Lender, when and if designated by MCE, and represents and warrants that it has all necessary authority and agrees to take all steps and execute and deliver all necessary documentation contemplated by Attachment B.

ARTICLE 3

USE OF PROCEEDS

Section 3.1. Use. The proceeds borrowed by MCE under the Guaranteed Loan may be used in whole or part for those charitable purposes that are more particularly described in the Information Memorandum; provided, however, under no circumstances shall the proceeds of the Guaranteed Loan be used for any of the following purposes:

(a) to service interest, expense or principal payments under any other Guaranteed Loan obtained by MCE under its philanthropic guarantee program if at such time any Microcredit Loan is then in default;

(b) to carry on propaganda or otherwise to attempt to influence legislation (within the meaning of Section 4945(d)(1) of the Internal Revenue Code of 1986, as amended ("Code")), or to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of Section 4945(d)(2) of the Code).

Section 3.2. Designation of Lender; Drawdowns.

(a) Guarantor acknowledges that by entering into this Agreement that Guarantor is agreeing to become a part of MCE's program and part of its Risk Pool for up to \$1,000,000.00 and Guarantor acknowledges that realized losses on Microcredit Loans will be allocated to Guarantor on a *pro rata* basis. Irrespective of whether MCE has entered into a Guaranteed Loan or made additional borrowings with respect to or based upon Guarantor's commitment, or if MCE has entered into a Guaranteed Loan or made additional borrowings irrespective of whether MCE has borrowed the maximum amount which can be advanced thereunder, Guarantor is at all times nevertheless liable for his, her or its *pro rata* share of all risks, as more particularly described in Section 4.2.

(b) Guarantor further acknowledges that MCE does NOT necessarily intend to draw down the Guaranteed Loans which are extended to it by Lenders on a *pro rata* or equal basis. MCE will generally draw down first on Guaranteed Loans with the most favorable terms and conditions consistent with standard business practices to minimize the risk of Microcredit Loan defaults.

ARTICLE 4

ADMINISTRATION OF PROGRAM

Section 4.1. Responsibilities. MCE shall be responsible for facilitating its philanthropic guarantee program, including among the various Lenders from whom it has borrowed. Such facilitation shall include MCE: (a) diligencing, sourcing, reviewing and making Microcredit Loans based upon the recommendations of

MCE's Loan Committee; (b) monitoring Microcredit Loans, reviewing all periodic and other reports thereunder and determining when and how to enforce the terms thereof; and (c) recognizing and applying any losses suffered in excess of any applicable loan loss reserves among all Guarantors on a *pro rata* basis as more particularly described in Section 4.2, including, to the extent necessary, foreclosing upon any security interests granted in favor of MCE.

Section 4.2. Loss Allocations. Subject to the limitation set forth in Section 1.1, any losses realized by MCE on Microcredit Loans shall be allocated *pro rata*, based upon each Guarantor's commitment to the program (*i.e.*, allocated *pro rata* based upon the \$1 million increments with which each Guarantor participates), among all Guarantors in MCE's philanthropic guarantee program (such group of Guarantors, collectively, the "**Risk Pool**") at the time such losses are realized by MCE (each Guarantor's allocation being referred to under this Agreement as his/her/its "**Loss Amount**"). MCE may elect in its sole discretion, but is not obligated to, establish loan loss reserves with respect to loans. MCE shall be obligated to realize and allocate among the Guarantors such a loss at the time a Microcredit Loan is defaulted upon, all applicable cure periods thereunder have expired and all efforts by MCE to have the microfinance institution or network repay such loan within a reasonable time after such default have failed; provided, however, that in no event shall MCE allow any such cure or repayment period to extend beyond one hundred eighty (180) calendar days from the initial due date of such repayment, and to the extent any such Microcredit Loan is not repaid within such one hundred eighty (180) calendar day period from the initial due date thereof MCE shall realize and allocate such loss among its Guarantors in accordance with this Section 4.2. Guarantor hereby agrees to fund each Loss Amount to MCE within ten (10) calendar days after written demand by MCE therefor.

Section 4.3. Subsequent Recoveries. In the event that after any loss is realized by MCE and allocated, and a Loss Amount is actually borne by the Guarantors, MCE is repaid any or all of such Loss Amounts from the microfinance institution or network ("**Recovered Amounts**"), then MCE shall pay such Recovered Amounts to the Guarantors who bore such Loss Amounts on a *pro rata* basis based upon the Loss Amounts borne by such Guarantors.

ARTICLE 5

STANDARD OF CARE

MCE and Guarantor each acknowledge and agree that they are entering into this Agreement and that MCE has organized and is operating its philanthropic guarantee program with the sole intention of making Microcredit Loans available to assist impoverished entrepreneurs. Guarantor has no expectation of profit and understands that it may suffer a loss of up to \$1,000,000.00.

MCE shall observe, conduct and perform its obligations under and to the extent contemplated by this Agreement, in making Microcredit Loans and generally in all regards with respect to its philanthropic guarantor program with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity with similar philanthropic motivations and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims as MCE (the “**Standard of Care**”). In the performance of its duties hereunder, the actions of MCE shall be based on its prudent judgment, and the judgment of its Loan Committee as a group with respect to the Microcredit Loans it makes, but in no way shall MCE be considered or construed to be a fiduciary or guaranteeing a preservation of capital or avoidance of losses to Guarantor. MCE will not be liable for any actions taken or omitted by it in connection with its philanthropic guarantee program or other activities absent willful misconduct or fraud on the part of MCE or its officers, directors or employees.

ARTICLE 6

REPRESENTATIONS AND WARRANTIES OF GUARANTOR

Guarantor hereby represents and warrants to MCE and for the benefit of MCE's Lenders as follows:

Section 6.1. Authority; Enforceability. This Agreement (including all applicable Attachments) and any other documents executed and delivered in connection herewith have been duly authorized, executed and delivered by Guarantor. This Agreement and any such other documents constitute valid and binding agreements of Guarantor, enforceable against Guarantor in accordance with their respective terms. All consents and approvals required of Guarantor to enter into and perform under this Agreement and any other documents executed and delivered in connection herewith, including without limitation all board of directors' votes or consents, member or partner votes or consents or all spousal consents, as applicable, have been obtained.

Section 6.2. Guarantor Eligibility. Guarantor is (a) an “accredited investor” as such term is defined in Rule 501(a) of Regulation D under the Securities Act and hereby makes the representations and warranties contained in Attachment C or (b) a tax-exempt entity described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended.

Section 6.3. Sophistication. Guarantor has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of its obligations to MCE and the program and making an informed decision with respect thereto, and is able to bear the economic risk of a complete loss of \$1,000,000.00. Guarantor understands that MCE is a recently-formed entity and it has limited operating history and no prior results. Guarantor has carefully

reviewed and fully understands the provisions of this Agreement and all documentation and agreements related hereto.

Section 6.4. Adequate Information; No Reliance; Subject to Change.

Guarantor has availed itself of, and has carefully read and understands all provisions of, this Agreement (including all exhibits and Attachments hereto), the Information Memorandum and the contents of MCE's website (which Guarantor hereby acknowledges is changed, updated and supplemented from time to time) (collectively, the "**Furnished Information**"). In considering his, her or its obligations under this Agreement, Guarantor has been given the opportunity to (a) make a thorough investigation of the current and proposed activities of MCE, has been furnished with all materials relating to MCE, its philanthropic guarantee program and its proposed activities that Guarantor has requested, and Guarantor has been afforded the opportunity to obtain any additional information necessary to verify the accuracy of any representations made or information conveyed to Guarantor, and (b) ask questions of, and receive answers from, MCE concerning the terms and conditions and other matters relevant to its obligations under this Agreement. In considering his, her or its Guarantee, Guarantor has not relied upon any representations made by, or other information (whether oral or written) furnished by or on behalf of, MCE, or any director, officer, employee, agent, advisor to or member of MCE or any affiliate of such persons, other than as set forth in writing in the Furnished Information. Guarantor has carefully considered and has discussed with his, her or its own legal, tax, accounting and financial advisers the suitability and potential risks of the Guarantee and obligations under this Agreement in light of his, her or its particular tax and financial situation, and has determined that entering into this Agreement and performing the obligations hereunder are suitable for him, her or it. Guarantor hereby acknowledges and agrees that it shall periodically review the contents of MCE's website and that it shall be deemed to have knowledge of all information set forth thereon at all times during the term of this Agreement. Guarantor acknowledges and agrees that while the terms of this Agreement may not be amended without Guarantor's consent, the Furnished Information (including on the website) can and will from time to time be changed, updated and supplemented from time to time without Guarantor's consent and without altering Guarantor's obligations under this Agreement.

Section 6.5. Entity Authority; Non-Contravention. If Guarantor is an entity: (a) it was not formed or recapitalized (*e.g.*, through new investments made in Guarantor solely for the purpose of financing its Guarantee or obligations hereunder) for the purpose of participating in MCE's philanthropic guarantee program; (b) its decision to enter into and perform under this Agreement was made in accordance with appropriate and customary formalities for such entity; (c) it is not managed to facilitate the individual decisions of its beneficial owners regarding financial decisions (including entering into and performing under this Agreement) or investments; (d) its shareholders, partners, members or beneficiaries, as applicable, did not and will not (i) have any discretion to determine whether or how much of Guarantor's assets are invested in any investment made by Guarantor or otherwise

utilized (including entering into and performing under this Agreement), or (ii) have the ability individually to elect whether or to what extent such shareholder, partner, member or beneficiary, as applicable, will participate in Guarantor's performance of its obligations under this Agreement; (e) it is duly organized or formed, validly existing and in good standing under the laws of its jurisdiction of organization or formation, and the execution, delivery and performance by it of this Agreement are within its powers, have been duly authorized by all necessary corporate or other action on its behalf, require no action by or in respect of, or filing with, any governmental body, agency or official, and do not and will not contravene, or constitute a default under, any provision of applicable law or regulation or of its certificate of incorporation or other comparable organizational documents or any agreement, judgment, injunction, order, decree or other instrument to which Guarantor is a party or by which Guarantor or any of its properties is bound; and (f) it has its principal place of business as set forth on the first page hereof.

Section 6.6. Natural Person Authority; Non-Contravention. If Guarantor is a natural person, the execution, delivery and performance by Guarantor of this Agreement are within the Guarantor's legal right, power and capacity, require no action by or in respect of, or filing with, any spouse, governmental body, agency or official, and do not and will not contravene, or constitute a default under, any provision of applicable law or regulation or of any agreement, mortgage, pledge, judgment, injunction, order, decree or other instrument to which Guarantor is a party or by which Guarantor or any of his or her properties is bound.

Section 6.7. Withdrawal Date. Guarantor acknowledges the necessity of regulating his, her or its Withdrawal Date in order to (a) provide each other Guarantor in the philanthropic guarantee program the opportunity to calculate the expected ingress and egress of other Guarantors and, thus, make a reasonable estimate about his, her or its relative individual risk exposure and (b) to provide a stable collateral base for MCE, thus, assuring that MCE is able to both monitor the financial risks for Guarantors and sustain the program for the benefit of entrepreneurs receiving Microcredit Loans.

ARTICLE 7

COVENANTS OF GUARANTOR

From the date of this Agreement through and including the Withdrawal Date, Guarantor hereby covenants for the benefit of MCE and for the benefit of its Lenders as follows:

Section 7.1. Guarantor Category. Guarantor shall at all times comply with all covenants applicable to its selected Guarantor Category, and all such applicable covenants shall be deemed included herein by this reference.

Section 7.2. Change in Information. Guarantor shall immediately notify MCE and, if requested by MCE, one or more Lenders of any changes in the information provided in this Agreement (including the Attachments hereto), and shall immediately notify MCE upon discovering that any of the representations or warranties made herein were false when made or has, as a result of changes in circumstances, become false at any time prior to the Withdrawal Date.

Section 7.3. Conduct of Business. Guarantor shall conduct its business and affairs (including its financial affairs and investment activities) in a manner such that it will be able to honor its obligations under this Agreement and under all agreements and documents entered into between Guarantor and Lender.

Section 7.4. Cooperation with Law Enforcement. Guarantor acknowledges that MCE seeks to comply at all times with applicable anti-money laundering laws and that it is MCE's policy to cooperate fully with all law enforcement agencies. To assist MCE in its efforts to comply with anti-money laundering and other laws and to cooperate with all authorities, Guarantor represents that none of the funds or , if applicable, collateral to be utilized or accessed in connection with this Agreement and Guarantor's obligations hereunder are or will be, directly or indirectly, derived from or related to, any activity that is deemed criminal under, or that may be in contravention of, federal, state or foreign laws, rules or regulations, including anti-money laundering laws, rules or regulations. Guarantor understands and agrees that MCE may undertake any actions that MCE deems necessary or appropriate to ensure compliance and cooperation with applicable laws, rules and regulations, including, repaying and terminating one or more Loans or Guaranteed Loans and/or terminating Guarantor's participation in the philanthropic guarantee program in the event that the foregoing representation by Guarantor is incorrect or in the event that for any other reason Guarantor's participation in the philanthropic guarantee program violates or is asserted by any law enforcement agency to violate any law, rule or regulation. Guarantor also understands and agrees that MCE may release confidential information about Guarantor, including with respect to any pledged collateral, and, if applicable, any underlying beneficial owners of Guarantor, to law enforcement agencies to the extent necessary to ensure cooperation and compliance with all applicable laws, rules and regulations.

Section 7.4. Information. Guarantor agrees to in good faith (i) share its financial statements and other information reasonably requested by MCE or one or more of its Lenders, (ii) enter into documentation and agreements mutually acceptable to a Lender, MCE and Guarantor, to facilitate MCE borrowing against Guarantor's participation in the philanthropic guarantee program, including in the case of a Signature Guarantor or a Collateral Guarantor a full-recourse guarantee of up to \$1,000,000 of such a borrowing.

ARTICLE 8

EXCULPATION AND INDEMNIFICATION

Section 8.1. Indemnification. Subject to the limitation set forth in Section 1.1, Guarantor shall indemnify MCE and its respective partners, members, shareholders, officers, directors, trust managers, representatives, advisors and agents (each an "**Indemnified Party**") from and against any and all losses, claims, damages, liabilities, joint or several, expenses (including reasonable legal fees and expenses), judgments, fines, settlements, and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil, criminal, administrative or investigative, that are instituted by any persons or entities (other than the Indemnified Party seeking indemnification hereunder) that relate to or arise from the actions and transactions contemplated by this Agreement, including without limitation any documentation entered into with Lenders in connection herewith, unless it is established that the act or omission of such Indemnified Party was a material cause of, or a material contributing factor to, the matter giving rise to the proceeding and was the result of willful misconduct or fraud. The termination of any proceeding by judgment, order or settlement does not, without a finding or judgment that the requisite standard of conduct was not met, create a presumption that the Indemnified Party did not meet the requisite standard of conduct.

Section 8.2. Non-exclusive Nature. The indemnification provided by this Article 8 shall be in addition to any other rights to which the Indemnitees may be entitled under any other agreement, insurance policy, as a matter of law, or otherwise.

Section 8.3. Insurance. MCE may, but shall not be obligated to, purchase and maintain insurance on behalf of the Indemnified Parties, against any liability that may be asserted against or expenses that may be incurred by the Indemnified Parties in connection with MCE's activities, regardless of whether MCE would have the power to indemnify the Indemnified Parties against such liability under the provisions of this Agreement.

Section 8.4. Beneficiaries. The provisions of this Article 8 are for the sole and exclusive benefit of the Indemnified Parties (and may be enforced thereby) and shall not be deemed to create any rights for the benefit of any other persons or entities.

ARTICLE 9

MISCELLANEOUS

Section 9.1 Address. Unless otherwise indicated, the address on the first page of this Agreement is the legal residence, if an individual, or the principal place

of business, if an entity, of Guarantor, and the decision to enter into this Agreement and participate in the philanthropic guarantee program was made at such address.

Section 9.2 Remedies. Guarantor understands the meaning and legal consequences of its covenants, representations and warranties contained herein, and hereby agrees that MCE and its Lenders may recover from Guarantor, and Guarantor shall hold MCE and Lenders harmless from, any and all loss, damage or liability due to or arising out of any breach of any such covenant, representation or warranty.

Section 9.3 Communication. Any notice, demand, request or other communication which may be required or contemplated herein shall be in writing and shall be sufficiently given if personally delivered, transmitted by facsimile, or sent postage prepaid by overnight courier or registered or certified mail, return receipt requested, addressed as follows: if intended for MCE, to MCE's principal business office at c/o Nossaman Guthner Knox & Elliott, 915 L Street, Suite 1000, Sacramento, CA 95814, Attn: Karen L. Roberts, Chief Administrative Officer, and if intended for Guarantor, to the address of Guarantor as indicated herein, or to such other address as Guarantor may designate from time to time by written notice to MCE.

Section 9.4. Third-Party Beneficiaries. Except with respect to Article 8 and MCE's Lenders, the provisions of this Agreement are not intended to be for the benefit of any person or entity other than the parties hereto, and no other person or entity shall obtain any rights under this Agreement or shall, by reason of this Agreement, be permitted to make any claim against MCE or Guarantor.

Section 9.5. Successors and Assigns. This Agreement shall be binding upon the heirs, executors, administrators, successors and permitted assigns of Guarantor and of MCE. Absent the consent of MCE, which may be withheld in its sole and absolute discretion, none of this Agreement nor the obligations or responsibilities hereunder may be assigned in whole or part by Guarantor. MCE may assign, transfer or grant an interest in, in whole or part, its interest in this Agreement and the Guarantor's obligations hereunder, and Guarantor agrees to attorn to any such assignee.

Section 9.6. Amendment; Waiver. Neither this Agreement nor any provision hereof may be waived, modified, discharged or terminated except by an instrument in writing signed by the party against whom such waiver, modification, discharge or termination is sought to be enforced.

Section 9.7. Integration. This Agreement (including the Attachments and schedules hereto) constitutes the entire agreement among the parties hereto pertaining to the subject matter hereof and supersede all prior and contemporaneous agreements and understandings of the parties in connection therewith. No covenant, representation or condition not expressed in this

Agreement, Information Memorandum or MCE's website shall affect, or be effective to interpret, change or restrict, the express provisions of this Agreement.

Section 9.8. Counterparts. *This Agreement may be executed in counterparts, with the same effect as if the parties executing the counterparts had all executed one counterpart.*

Section 9.9. Headings. *The section and subsection headings used herein are for convenience only and shall not affect the interpretation of any term or provision of this Agreement.*

Section 9.10. Governing Law. *This Agreement shall be governed by and construed in accordance with the laws of the State of California, without regard to conflicts of laws provisions.*

Section 9.11. Dispute Resolution.

Section 9.11.1. Arbitration. All disputes, claims, or controversies arising out of or relating to this Agreement, or any other agreement executed and delivered pursuant to this Agreement, or the negotiation, validity or performance hereof and thereof or the transactions contemplated hereby and thereby, that are not resolved by mutual agreement shall be resolved solely and exclusively by binding arbitration to be conducted before The American Arbitration Association or its successor. The parties understand and agree that this arbitration provision shall apply equally to claims of fraud or fraud in the inducement and those relating to federal and/or state securities laws. The arbitration shall be held in Sacramento, California before a single arbitrator and shall be conducted in accordance with the rules and regulations promulgated by The American Arbitration Association unless specifically modified herein.

Section 9.11.2. Procedures. The parties covenant and agree that the arbitration shall commence within one hundred twenty (120) calendar days of the date on which a written demand for arbitration is filed by any party hereto. In connection with the arbitration proceeding, the arbitrator shall have the power to order the production of documents by each party and any third-party witnesses. In addition, each party may take up to three depositions as of right, and the arbitrator may in his or her discretion allow additional depositions upon good cause shown by the moving party. However, the arbitrator shall not have the power to order the answering of interrogatories or the response to requests for admission. In connection with any arbitration, each party shall provide to the other, no later than twenty one (21) calendar days before the date of the arbitration, the identity of all persons that may testify at the arbitration, a copy of all documents that may be introduced at the arbitration or considered or used by a party's witness or expert, and a summary of the expert's opinions and the basis for said opinions. The arbitrator's decision and award shall be made and delivered within sixty (60)

calendar days of the conclusion of the arbitration. The arbitrator's decision shall set forth a reasoned basis for any award of damages or finding of liability. The arbitrator shall not have power to award damages in excess of actual compensatory damages and shall not multiply actual damages or award punitive damages or any other damages that are specifically excluded under this Agreement, and each party hereby irrevocably waives any claim to such damages.

Section 9.11.3. Costs. The parties covenant and agree that they will participate in the arbitration in good faith and that they will share equally its costs, except as otherwise provided herein. The arbitrator may in his or her discretion assess costs and expenses (including the reasonable legal fees and expenses of the prevailing party) against any party to a proceeding. Any party unsuccessfully refusing to comply with an order of the arbitrators shall be liable for costs and expenses, including attorneys' fees, incurred by the other party in enforcing the award. This Section 9.11 applies equally to requests for temporary, preliminary or permanent injunctive relief, except that in the case of temporary or preliminary injunctive relief any party may proceed in court without prior arbitration for the limited purpose of avoiding immediate and irreparable harm. The provisions of this Section 9.11 shall be enforceable in any court of competent jurisdiction.

Section 9.11.4. Fees. Subject to the second sentence of the immediately preceding paragraph, the parties shall bear their own attorneys' fees, costs and expenses in connection with the arbitration. The parties will share equally in the fees and expenses charged by The American Arbitration Association.

Section 9.11.5. Exclusive Jurisdiction. Each of the parties hereto irrevocably and unconditionally consents to the exclusive jurisdiction of The American Arbitration Association to resolve all disputes, claims or controversies arising out of or relating to this Agreement or any other agreement executed and delivered pursuant to this Agreement or the negotiation, validity or performance hereof and thereof or the transactions contemplated hereby and thereby and further consents to the jurisdiction of the federal and state courts located in Sacramento, California for the purposes of enforcing the arbitration provisions of Section 9.11 of this Agreement. Each party further irrevocably waives any objection to proceeding before The American Arbitration Association based upon lack of personal jurisdiction or to the laying of venue and further irrevocably and unconditionally waives and agrees not to make a claim in any court that arbitration before The American Arbitration Association has been brought in an inconvenient forum. Each of the parties hereto hereby consents to service of process by registered mail at the address to which notices are to be given. Each of the parties hereto agrees that its or his submission to jurisdiction and its or his consent to service of process by mail is made for the express benefit of the other parties hereto.

Section 9.12. Not a Partnership. Nothing in this Agreement and no action taken by the parties pursuant to this Agreement shall constitute, or be deemed to constitute, the parties entering into any form of partnership, joint venture, collective investment vehicle or any other legal structure or arrangement other than a contractual relationship.

Section 9.13. Severability. If any one or more of the covenants, agreements, provisions or terms of this Agreement shall be held contrary to any express provision of law or contrary to policy of express law, though not expressly prohibited or against public policy, or shall for any reason whatsoever be held invalid, then such covenants, agreements, provisions or terms shall be deemed severable from the remaining covenants, agreements, provisions or terms of this Agreement and in no way shall affect the validity or enforceability of the other provisions of this Agreement.

Section 9.14. Participation in Program Does Not Involve a Securities Offering. MicroCredit Enterprises is not a socially responsible fund or an investment of any kind. MicroCredit Enterprises is not operated as a profit-seeking venture for the benefit of any individual or institution.

IN WITNESS WHEREOF, this Agreement is entered into and effective as of the date first set forth above.

MCE:

MICROCREDIT ENTERPRISES, INC.
a California corporation

By: _____

Jonathan C. Lewis
Chief Executive Officer

GUARANTOR:

By: _____

Print Name: _____

Title: _____

(or, for natural persons):

Print Name: _____

Disclosure. Guarantor hereby consents to the disclosure by MCE of its identity and its participation in the philanthropic guarantee program in response to requests for information by other prospective participants, Lenders or other transaction parties or counter-parties, including without limitation on MCE's website.

Please check/initial one: ____ YES ____ NO

Attachment A

Signatory Guarantor

This Attachment A is only applicable to a Signatory Guarantor

By signing below, Guarantor further agrees with MCE to the following:

- Guarantor agrees to provide a full recourse guarantee for an amount up to, but not to exceed \$1 million, to a Lender upon written designation of such Lender by MCE.

The agreements set forth in this Attachment A supplement, and are to be read together with and incorporated into, the Philanthropic Guarantee Agreement (the "**Agreement**") which accompanies this Attachment A. Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Agreement.

IN WITNESS WHEREOF, this Attachment A is entered into as of the date of the Agreement by the parties hereto.

GUARANTOR:

By: _____

Print Name: _____

Title: _____

(or, for natural persons):

Print Name: _____

MCE:

MICROCREDIT ENTERPRISES, INC.,
a California corporation

By: _____

Jonathan C. Lewis
Chief Executive Officer

Attachment B

Collateral Guarantor

This Attachment B is only applicable to a Collateral Guarantor

Guarantor, by joining the philanthropic guarantee program in the Collateral Guarantor Category, and MCE hereby further agree as set forth in this Attachment B. The agreements set forth in this Attachment B supplement, and are to be read together with and incorporated into, the Philanthropic Guarantee Agreement (the "**Agreement**") which accompanies this Attachment B. Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Agreement.

Guarantor agrees with MCE to the following:

- Guarantor agrees to provide a full recourse guarantee for an amount up to, but not to exceed \$1 million, secured by a pledge of the Collateral in favor of the Lender, to a Lender upon written designation of such Lender by MCE; and
- The "Collateral" is more completely described as follows:

(including with respect to the identified collateral, all accessions and additions thereto, replacements and substitutions therefor and proceeds and products thereof, collectively, the "**Collateral**")

Security Interest.

Section B.1. Grant of Security. Guarantor hereby pledges, transfers, assigns, sets over and grants to MCE a continuing security interest in the Collateral (as defined in Section 1.2 of the Agreement) (the "**MCE Security Interest**"). The MCE Security Interest shall be first in priority until such time as MCE designates a Lender and enters into a Guaranteed Loan with respect to Guarantor's commitment in this Agreement, at which time MCE, Guarantor and the Lender on such Guaranteed Loan shall enter into a Guarantee, Pledge and Security Agreement and/or other loan documentation which shall, among other

things, grant the Lender a first priority security interest in the Collateral and subordinate the MCE Security Interest to such Lender's security interest.

Section B.2. Security for Obligations. This Agreement and the MCE Security Interest shall secure the payment and performance of: (a) the due and punctual payment of all Loss Amounts; (b) all other obligations of Guarantor to MCE pursuant to or as contemplated by this Agreement; and (c) any and all costs and expenses incurred or paid by MCE to enforce its rights pursuant to this Agreement (including without limitation reasonable attorney's fees and expenses). MCE shall be under no obligation, and subject to this Section B, may not be entitled, to proceed against any or all of the Collateral before proceeding directly against Guarantor or against any asset of Guarantor.

Section B.3. Continuation of Security Interest. The MCE Security Interest granted in this Agreement shall continue in full force and effect until Guarantor has fully satisfied and discharged all of its obligations contemplated by this Agreement and until the Withdrawal Date as contemplated by Section 1.3.1 of the Agreement.

Section B.4. Further Assurances. Guarantor shall take and permit such steps and execute and deliver such UCC financing statements, mortgages and other documents, including without limitation an account control agreement in the case of bank or securities accounts, all in form and substance satisfactory to MCE and Lender relating to the creation, validity or perfection of the security interests provided for herein under the Uniform Commercial Code (UCC) or other applicable laws.

Section B.5. Power to File Financing Statements. MCE is hereby irrevocably appointed by Guarantor as its lawful attorney and agent in fact to authenticate and file UCC financing statements for the purpose of perfecting and continuing any security interests or liens under any applicable law.

Section B.6. Subordination. Guarantor and MCE agree that the MCE Security Interest granted by Guarantor in favor of MCE herein shall become second in priority and subordinate in all respects to the security interest in the Collateral granted by Guarantor in favor of a Lender. Guarantor hereby agrees to take and permit all steps and to execute and deliver all documents reasonably requested by Lender to effectuate such subordination.

Section B.7. Authority. Guarantor hereby represents and warrants that the MCE Security Interest granted herein and any future security interest granted in the Collateral to a Lender constitute valid and binding agreements of Guarantor, enforceable against Guarantor in accordance with their respective terms. No consents or approvals are required of Guarantor or any third party for Guarantor to enter into and perform under the MCE Security Interest and any security interest granted in the Collateral to a Lender, or to the extent any

consents or approvals are required Guarantor represents that all required consents and approvals have been obtained.

IN WITNESS WHEREOF, Attachment B is entered into as of the date of the Agreement by the parties hereto.

GUARANTOR:

By: _____

Print Name: _____

Title: _____

(or, for natural persons):

Print Name: _____

MCE:

MICROCREDIT ENTERPRISES, INC.,
a California corporation

By: _____

Jonathan C. Lewis
Chief Executive Officer

ATTACHMENT C

Guarantor Questionnaire

Name: _____

Address: _____

The Guarantor represents and warrants that he, she or it is:

1. _____ A tax-exempt entity described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended.

OR

2. _____ an Accredited Investor for one or more of the reasons specified below (please check all boxes that apply):

- The Guarantor is a natural person and (check all that apply):
 - has an individual net worth, or joint net worth with the Guarantor's spouse, in excess of \$1,000,000; and/or
 - had an individual income in excess of \$200,000 (or a joint income together with the Guarantor's spouse in excess of \$300,000) in each of the two most recently completed calendar years, and reasonably expects to have an individual income in excess of \$200,000 (or a joint income together with the Guarantor's spouse in excess of \$300,000) in the current calendar year.

- The Guarantor is an entity and is (check all that apply):
 - a bank as defined in Section 3(a)(2) of the Securities Act, a savings and loan association or other institution as defined in Section 3(a)(5)(A) of the Securities Act, acting in either its individual or fiduciary capacity;
 - a trust with total assets in excess of \$5,000,000, not formed for the specific purpose of acquiring the Interest and the decision to acquire the Interest is being directed by a person who has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of investing in the Partnership;
 - a corporation, a Massachusetts or similar business trust, a partnership or a limited liability company, not formed for the specific purpose of acquiring the Interest, with total assets in excess of \$5,000,000;
 - a plan for the benefit of employees, established and maintained by a state, its political subdivisions, or an agency or instrumentality of a state or its political subdivisions, if such plan has total assets in excess of \$5,000,000;
 - an employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974, as amended ("**ERISA**"), (a) for which the investment decision to the Interest is being made by a plan fiduciary, as defined in Section 3(21) of ERISA, which is either a bank, savings and loan association, insurance company, or registered investment adviser, (b) which has total assets in excess of \$5,000,000, or (c) which is self-directed plan with the investment decisions made solely by persons who are "accredited investors";
 - a broker or dealer registered under Section 15 of the Securities Exchange Act of 1934, as amended;
 - an insurance company as defined in Section 2(13) of the Securities Act;

- an investment company registered under the Investment Company Act
- a business development company as defined in Section 2(a)(48) of the Investment Company Act;
- a Small Business Investment Company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958, as amended; and/or
- a private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940, as amended; and/or
- an entity in which all of the equity owners are “accredited investors,” as described above.

Executed and delivered as of _____, 200 ____.

Name of Entity: _____

By: _____

Title: _____

(or, for natural persons):

Print Name: _____