# BUILDING ENDOWMENT WITH PLANNED GIFTS

## PG CALC WEBINAR

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# I. Introduction

There are several dimensions to consider when a donor arranges a planned gift. One is the timing - is it a current or deferred gift? Another is its purpose – is it unrestricted or directed to a particular use? A third consideration is its term of existence – once received, can it be used for the intended purpose in full or is a portion to be held in perpetuity? Sometimes these notions become intertwined and an assumption is made that a deferred gift* means endowment and vice versa.

We know this is not the case; a charity can have an endowment without a planned giving program and, conversely, a charity can promote planned gifts without offering endowment as a gift option. However, the two gift types do have areas of overlap, are in many ways natural partners, and can lend synergy to one another. While ultimately distinct, planned gifts are generally well suited for bolstering endowment, and planned gifts often build endowments.

This paper will explore state laws governing spending policies regarding endowments and rules governing management of endowments. We will explore why planned gifts are integral to building endowment and how to increase and strengthen a charity's endowment program using planned giving. Essential to this is an understanding of endowment basics and the natural affinities between planned giving and endowment.

* A planned gift is usually considered a deferred gift although a planned gift can be current or deferred (the vast majority are indeed deferred) and that is the meaning the term will have in this paper.

# II. Endowment: The Basics

## A. Endowment and endowment-like arrangements

### 1. Definition of "Endowment"

An endowment, as generally understood, is a permanent fund and its principal is essentially inviolate (this is sometimes referred to as a "true endowment"); although a more accurate concept is that an endowment is a gift that is not wholly expendable on a current basis. In determining what percentage of an endowment may be spent each year, the charity may look beyond the interest and dividends earned from investing the principal. Using modern portfolio theory and state law governing endowments, endowment income may also include a portion of any increase (realized or unrealized) in the value of the endowment principal as well as a portion of the principal itself. Nonetheless, a donor may explicitly prohibit the spending of principal appreciation or the invasion of principal.

Whereas endowment assets were traditionally invested to maximize interest and dividends, in recent decades – as a result of changes in the law that now permit the spending of some measure of appreciation and even some measure of the principal itself – endowment assets are increasingly invested to maximize total return. Ideally, some of the increase in the value of the principal will be retained by the endowment to offset, either partially or completely, the effects of inflation.

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Even though an endowment is traditionally created by virtue of a donor restricting his or her contribution for endowment **and by the charity accepting the limitation**, the purposes to be supported through distributions from the endowment may or may not be specified by the donor. If there is such specification, it can take the form of either a binding limitation or a mere expression of preference. Moreover, a donor and a charity can also agree upon numerous other details of an endowment arrangement. To the extent the donor and the charity do not address any particular issue, state law provides "default" provisions.

**2. Types of Endowments**

**a. True Endowment**

True endowment funds (also known as permanent endowment funds) are resources with respect to which a donor has stipulated, as a condition of the gift, that the gift is to be maintained inviolate and in perpetuity. A true endowment is to be invested for the purpose of producing present and future income that may, also by donor stipulation, be expended or reinvested with the original gift. The principal or corpus of the true endowment must be maintained intact. Income that may be expended according to the donor's stipulation may be unrestricted or restricted as to the purpose for which it is expended, the time it may be expended, or both. Income that may not be expended but rather added to the principal or corpus in accordance with the donor's stipulation assumes the same restrictions as the original gift. Source: NACUBO Accounting Tutorial – Endowment Definitions, but see Uniform Prudent Management of Institutional Funds Act and discussion in Section III.

**b. Term Endowment**

Under such an arrangement, principal may be spent or otherwise invaded only upon an eventuality identified by the donor (e.g., after a certain date, upon the happening of a particular event). Prior to that time, the endowment is administered as a true endowment.

**c. Self-Liquidating Endowment**

In contrast to a term endowment, a self-liquidating endowment involves a mandatory distribution of all principal and income by a certain date.

**d. Quasi or Board-Designated Endowment**

Such an arrangement is considered to be "funds functioning as endowment." On the one hand, principal can remain intact indefinitely, without reference to a certain date or other eventuality. On the other hand, the charity's governing board may, at any time, spend or otherwise invade some or even all of the principal. Although a donor can encourage the charity's board to create a quasi-endowment, more often it is the governing board that of its own volition earmarks otherwise unrestricted assets for a quasi-endowment. For this reason, a quasi-endowment is frequently referred to as a "board-designated endowment."

**e. Reserve Fund**

This is really not an endowment at all. Nevertheless, depending on a charity's needs and purposes, it may be an appropriate alternative or perhaps even a preferable alternative. The charity can choose whether to credit unexpended reserve account assets with whatever income may be attributable to investment of those assets. In addition, the


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charity can determine year-to-year whether to make any expenditures at all. Long-term security and stability are enhanced without sacrificing flexibility.

From a legal and accounting perspective, there is no difference between a quasi-endowment and a reserve fund. The difference lies in the organizational mindset when the fund is established. A quasi-endowment fund is usually regarded to be more or less inviolate, to be drawn down only in extreme circumstances or need. A reserve fund is generally viewed as being more flexible, with an expectation that monies will be drawn upon and replenished more often. Expenditures can usually be made more easily and quickly from a reserve fund than from quasi-endowment. For these reasons, quasi-endowment funds are more likely to be invested on a long-term basis, like true endowment, while reserve funds are invested on a more short-term basis.

Note: The five foregoing options are not mutually exclusive; any given organization may pursue more than one of them.

## B. Variations on an In-House Endowment

### 1. The Separate "Foundation" Option

Sometimes, a charity will create a separate entity (often a Type I supporting organization) to raise money and to have a certain portion of that money retained and managed as an endowment for the ultimate benefit of the charity. Even though such an entity usually has the word "foundation" in its name, it can take any of various forms. Typically, the sole mission of the separate entity will be to support the charity that created it. An example would be a hospital foundation. Depending on how a separate foundation is organized and operated, it may or may not be closely controlled by the main organization.

A charity may form a separate entity for several reasons. With a foundation taking on the responsibility for fundraising, the charity is freed to concentrate solely on programmatic aspects. It can serve to protect financial resources from certain third-party liabilities, and shield endowment funds from an internal pressure to spend. In addition, because there are separate structures and governing boards, more volunteer opportunities are created for the charity. (However, this can also possibly result in duplication of expenses for staff and other operational aspects, and some donors may find this objectionable.)

### 2. The Related Organization Option

In this instance, the charity that holds the endowment will likely have been created to advance any number of purposes, just one of which is to retain and manage endowment on behalf of other organizations. An example would be a denomination or other national or regional religious organization that carries on numerous activities, including holding endowments for affiliated faith communities and programs.

### 3. The Community Foundation Option

Even though community foundations, like related organizations, serve a variety of purposes, one of the most vital aspects of their missions is maintaining endowments for the benefit of


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other organizations. In so doing, they can afford such organizations (especially small ones) significant economies of scale in terms of the investment and administrative responsibilities associated with endowments. The tradeoff for these advantages is that the community foundation will collect an annual fee and determine the spending policy.

Especially with community foundations, but also with the other two options described above, one must distinguish between an endowment established by a donor with the community foundation directly and an endowment established at the community foundation by a particular organization itself. In other words, the charity can – in effect – offer donors the choice of making endowment contributions either to the community foundation or to the charity, in which case the charity would transfer to the community foundation the assets contributed.

Such transfers are typically irrevocable. This means:

a. The community foundation now owns the assets of the endowment and the charity no longer does (although, under certain circumstances, the governing board of the community foundation could elect to "grant" some or all of the endowment assets back to the charity).

b. The community foundation will manage the endowment for the benefit of the charity, but if the charity goes out of existence or loses its tax-exempt status, the community foundation – by virtue of its inherent "variance power" – will thereafter make distributions to organizations with missions similar to that of the original organization.

**4. The Private Trust "Option"**

A donor is always free to establish a trust that will operate (either for a period of time or in perpetuity) as an endowment for one or more organizations. Typically, a financial institution serves as trustee, with organizations that benefit from the trust doing little more than simply receiving distributions from the trust. Often, such an "endowment" is established by the donor unilaterally, without any involvement or perhaps even any initial knowledge on the part of any organization that will benefit. In this respect, it is to be distinguished from the three options above, all of which assume that the charity has made a deliberate decision about how it wants to secure endowment and is guiding its donors accordingly.

**5. Legal and Accounting Implications**

Depending on the arrangement a charity has with an entity that holds endowment on behalf of the charity, the principal and income of the endowment may or may not be considered assets of the charity itself. This, in turn, has implications for matters such as safeguarding endowment assets from court judgments rendered against the charity or meeting net asset criteria with respect to grants, insurance coverage, etc. Thus, to the extent a charity is contemplating setting up either an internal endowment or an external one, its legal counsel and its auditors should be consulted as to the implications associated with each option under consideration.


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# III. Endowment Structure and Management

## A. UPMIFA, Endowment Management and Spending

"UPMIFA" is the "Uniform Prudent Management of Institutional Funds Act." The National Conference of Commissioners on Uniform State Laws adopted UPMIFA in July 2006. UPMIFA replaces prior law, the Uniform Management of Institutional Funds Act" or UMIFA. To date, 49 states and the District of Columbia have adopted UPMIFA. Pennsylvania is the only state that has not adopted UPMIFA.*

Under prior law, UMIFA allowed for the concept of spending a prudent portion of the gains earned by an endowment, and not just interest, dividends and the like (the traditional definition of income in trust law). Nonetheless, under UMIFA, if the value of an endowment were ever to fall below the "historic dollar value" of the contribution made to the endowment, the endowment would need to determine what, if anything could be distributed from the endowment until the historic dollar value was attained once again. UPMIFA specifically eliminated the "historic dollar value" limitation.

* In Pennsylvania, not-for-profits with a formal written endowment policy can generally elect to spend 2 to 7 percent of the average market value of the endowment funds over the past three years (absent any other donor restrictions). If an organization has not adopted a written endowment policy, then generally the organization is restricted to follow trust law, which will only allow the organization to spend actual interest and dividends absent other donor intent. The organization's board of directors should adopt this spending policy on an annual basis, and have a prudent investment policy "consistent with the long-term preservation of the real value of the principal" of the endowment funds. See 15 Pa. C.S.A. §5548 and 20 Pa. C.S.A. Ch. 81.

**Key Features of UPMIFA**

1. UPMIFA applies to all charities, including those organized as trusts (although neither UMIFA nor UPMIFA applies to endowments held by corporate or individual trustees).

2. UPMIFA makes a radical change by eliminating the concept of an endowment's "historic dollar value." Charities are allowed to appropriate for expenditure, or accumulate, so much of an endowment fund (including perhaps principal) as the charity determines is prudent for the purposes for which the fund was established. UPMIFA specifies seven factors to be taken into consideration when determining how much of an endowment to distribute:

- the duration and preservation of the endowment fund,
- the purposes of the charity and the fund,
- general economic conditions,
- effects of inflation and deflation,
- expected total return from income and appreciation,
- the charity's other resources, and
- the charity's investment policy


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The model UPMIFA statute includes an optional provision stating than an appropriation of greater than 7% of the average FMV of an endowment (averaged over the last three years) is presumptively imprudent. Some states have adopted this provision while others have not.

3. Similarly, UPMIFA provides charities with much more specific guidance than does UMIFA with regard to the investment of endowment assets and the overall management of an endowment, as well as with regard to the delegation of these responsibilities.

UPMIFA requires the Board to act in good faith and with the care of an ordinary prudent person, and notes that the charity may incur only appropriate and reasonable costs. It articulates seven factors that charities must consider in making its investment decisions:

- general economic conditions,
- effects of inflation and deflation,
- tax consequences,
- the role of each investment in the overall portfolio,
- expected total return from income and appreciation,
- the charity's other resources, and
- the needs of the charity and the fund to make distributions and preserve capital

4. UPMIFA offers a charity more options than UMIFA did when restrictions placed upon an endowment by a donor become inappropriate in any of a number of respects. In particular, if a fund is less than $25,000 in value and over 20 years old, the charity can modify it without going to court. Some states have adopted higher threshold amounts and shorter time periods to remove restrictions. (For example, in Ohio, if an endowment is under $250,000 and over 10 years old, inappropriate endowment restrictions can be removed without going to court) If the charity determines that a restriction is unlawful, impracticable, impossible to achieve, or wasteful, it can release or modify the restriction. The charity must give notice of the change to the Attorney General and the donor, if living, and thereafter use the funds in a manner consistent with the donor's charitable purposes.

(For further information about UPMIFA, visit the official web site of the Uniform Law Commission which includes a summary of the act, an UPMIFA/ UMIFA comparison chart, and an enactment map: www.upmifa.org.)

**B. Endowment Spending Policies**

Organizations that host endowments apply a spending policy to most endowed funds. The endowment spending policy defines the amount of money that can be disbursed from a fund each year. The goal of the spending policy is to position the funds to maintain a balance between long-term investment growth and annual grant distributions.

The spending policy accomplishes two important goals. First, it maintains the purchasing power of the endowment (i.e., corpus adjusted for inflation), and preserves a fund's ability to meet the future purposes of the endowment. Second, application of the spending policy reduces the endowment's vulnerability to significant fluctuations in the financial markets.

It is common to set a spending policy by averaging market values over an extended period. Such a policy means endowment distributions are less subject to short-term fluctuations in


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market values. There is no single standard for averaging market values. Some charities look at average market values for as few as the last four quarters to as many as the trailing 28 quarters in determining spending policies.

For example, assume a spending policy that defines the distributable income from a fund in a given year as five percent of the fund's average market value over the preceding 16 quarters (i.e. the past four years). The charity would perform the calculation based on this average as of December 31 each year. The distribution for the next year would be based on the average market value computed as of the last day of the last 16 quarters. Assuming a 5% spending policy, the endowment's distribution would be 5% of that average market value.

The average market value of endowed funds that have not been invested in the endowment for the requisite number of quarters can be based on the number of quarters for which market value information is available. It is common for endowed funds that have not been in place for at least one year not to make distributions until they have been in place for at least one year.

## C. Endowment Policies: Managing Endowments and Donor Intent

The life of an endowment is essentially perpetual. Effective endowment policies guarantee prudent and efficient endowment management over the life of the hosting non-profit.

### A. Financial Management

A non-profit hosting endowment funds hires internal managers expert in the implementation of endowment policies, oversight of spending policies and administration, and engagement of competent money managers. External money managers should be experienced in and competent at investment of endowment funds.

A best practice is to create an investment committee comprised of internal stakeholders, including board members, business, treasurer and/or financial affairs representatives, and regular reporting from outside money managers.

An investment policy statement defines the goals of endowment investments, establishes an investment structure, and a target asset allocation. The stakeholders should establish performance and risk guidelines, and define the responsibilities of the members of the investment committee.

### B. Spending Policies

The investment committee should establish a spending policy consistent with the guidelines provided in UPMIFA discussed above. There are two main schools of thought on how to apply the principles of UPMIFA to spending from an endowment.

**Moving Average** Most endowments use a spending policy that uses a moving average of the value of the endowment over a multi-year period, typically three to five years. The purpose of the moving average approach is to smooth out the volatility of the endowment investments. The moving average approach results in less spending volatility in multi-year obligations such as grants and scholarships.


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**Inflation Based** Some endowments adjust their spending each year by taking the market value of the endowment last year and increasing it by an index such as the Consumer Price Index or the Higher Education Price Index. This approach smooths out volatility and maintains the purchasing power of the endowment spending dollars.

**Other Approaches** Some institutions merely apply the endowment spending rate adopted each year against the market value of the endowment at the end of the previous year. These endowments experience more volatility in their spending from year to year.

### C. Special Considerations with Respect to Named Endowed Funds

Even though the overall endowment policies and guidelines should indicate whether the organization would permit named endowed funds, the issues involved with such funds warrant a bit of special attention.

- Minimum amount needed to establish a named endowed fund.
  This amount may be different depending upon whether the fund is for general purposes or a more restricted purpose. The optimal amounts at an organization will be a function of marketing considerations, tolerance for administrative complexity, and the practicality of the funding level being sufficient to achieve its purpose at a meaningful level.

  This amount should be at least $10,000 for an endowed fund for unrestricted purposes and $25,000 for an endowed fund for a specific purpose. Many charities have established higher amounts than this, particularly as their endowment program has matured. Once a fund has been established, additional contributions of any amount can be made at any time.

- Requirements to establish a named endowed fund with a deferred gift.
  A donor may want to establish a named fund with the residuum of a gift annuity, remainder of a charitable remainder trust, or a residual bequest. The difficulty is that a charity does not know how much will be received or when, nor what the required minimum for an endowed fund may be at that time. This can be handled in a variety of ways:

  - Let the donor **"lock in"** at today's minimum amount even though the gift will not be received until some future time, perhaps 20 or 30 years from now. This is the default if a charity does not specify otherwise.

  - Use a rough **rule of thumb** by requiring that the amount of the deferred gift must equal some multiple of today's minimum. One charity requires that a deferred gift be for twice the amount of the current funding minimum, i.e., a bequest expectancy must be for $50,000 if the funding minimum is $25,000 when the bequest is arranged.

  - Require that the **present value** of the deferred gift be equal to the current minimum funding level.


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- Require that the amount simply be whatever the minimum funding level is **at the time the gift matures.** The charity would enter into an agreement with the donor to establish an endowed fund if that amount (whatever it might be) is ultimately received, reserving the right to use the funds outright if the matured gift is not sufficient in size. The charity should carefully monitor these gift arrangements and be sure to let the donor know when gift minimums are raised.

  This approach gives the greatest flexibility to the charity and ensures that endowed funds will not be established over time for less than the stated minimums. However, it gives the least peace of mind to the donor that they will ultimately be able to establish their own endowed fund. Also, expectations need to be skillfully managed so the donor does not feel like a "bait and switch" has taken place should they live a number of years more and endowment minimums increase during that time.

The more restrictive the purpose of the gift, the tighter the guidelines need to be to ensure an adequate funding level in the future.

- Whenever possible, try to have the donor sign an endowed fund agreement. Such a document would set forth the name of the fund and the purposes for which distributions would be made. It would also cover details associated with investment and management of the endowment, including determination of distribution amounts (typically through references to the organization's policies and guidelines, although the donor and the organization could agree to depart from the organization's standard procedure). Finally, it would include a "variance provision," effectively enabling the organization – acting unilaterally if the donor is no longer able to consent – to change the purposes for which distributions are made if the original purposes become impractical.

- Even if the donor intends to establish a named endowment by means of a bequest or other testamentary arrangement, it is still advisable to execute an endowed fund agreement. In the absence of a variance provision, the organization may need to go to court to alter the terms of the endowment. Executing an agreement also makes the gift more real for the donor and reinforces a revocable gift.

## D. Determining Whether to Accept Certain Endowment Gifts

The optimal arrangement within a charity for its endowment program is to have a partnership between the finance office and the development office. Finance will be responsible for the "back office" functions of the endowment – namely, the accounting, investment, and expenditure aspects. Development will be responsible for "front office" activities, those most directly involved with the donor, such as promoting gifts to endowment, endowment structure and policy, endowed gift agreements, and stewardship. While the latter are more visible, it takes both aspects functioning well to have a successful endowment program.

For many of the reasons discussed earlier, endowment responsibilities on the development side often devolve to the person(s) responsible for planned giving.


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In order to be successful, an endowment program has to be thoughtfully planned and carefully managed.

**1. Donor Restrictions**

Even if an organization has made the basic determination that it is willing to accept endowment gifts, in all probability it will from time to time be offered particular endowment gifts it is unwilling to accept. This may be a function of the asset to be contributed, in which case the decision is made based on the organization's gift acceptance policies. It may also be a function of the purpose to be furthered by the endowment, which may be inappropriate, too narrow, or not achievable given the proposed level of funding.

Regardless of the situation, the organization should be aware that a threshold determination will need to be made about the suitability of the gift the donor proposes to make. In most cases, there will be no reason to reject the gift, especially if concerns can be resolved through negotiation. This may be more difficult, however, if the gift is made on a testamentary basis with no opportunity to be in conversation with the donor prior to his or her death and if the estate's hands have been tied by the donor.

Some donors will make gifts subject to the restriction that the gift be held in endowment, but without designating a particular purpose or program to which the endowment spending is to be applied. Other donors direct their gift to endowment and impose restrictions, some very detailed and limiting, as to how to spend their endowment in the future.

Writing instructions should create endowed funds detailing donor preferences on investment and spending, if any. A charity must carefully consider whether the donor restrictions are currently, and frankly, in perpetuity within the mission of the charity. An initial threshold is whether the gift restriction and purpose are legal, consistent with the charity's mission and values, practical, and not frivolous.

History is replete with endowed gifts where donor restrictions may have seemed reasonable at the time, but history has proven otherwise. Augustus Octavius Bacon donated in his will land in the city of Macon, Georgia for "the use, benefit, and enjoyment of the white women and children of the city of Macon to be by them forever used and enjoyed as a park and pleasure ground." The United States Supreme Court held in Evans v. Abney, 396 U.S. 435 (1970) that the park was unable to perform his intended segregationist function. The land reverted to Bacon's heirs, who sold the property to private developers.

More recent history is replete with examples of frustrated donor intent being decided in court. William Robertson, et. al. v. Princeton University, et. al. Docket No. C-99-02, Superior Court of New Jersey, Chancery Division (Mercer County) involved the donor's bequest to fund the Woodrow Wilson School of Public and International Affairs at Princeton University. Princeton settled the suit by returning $90M to the donor's Foundation.

In Tennessee Division of the United Daughters of the Confederacy v. Vanderbilt University, 174 S. W. 3rd 98, 203 Ed. Law Rep. 396 Ct. App., 2005, the donors raised $50,000 to build a dormitory. A condition of the gift was that the residence hall bear the name, "Confederate Memorial Hall." The University renamed the hall without the donor's consent in 2002.


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Vanderbilt was forced to pay the Tennessee Division of the United Daughters of the Confederacy $1.2 million as a return in present value of the original $50,000 gift.

These cases stand as object lessons in completely considering the implications of donor intent. The parties must view the content of endowment agreements through the lens of future needs, future priorities, uncertain values, and the moral judgment of history yet unwritten.

**2. Endowment Accounting/Fund Tracking**

Although endowment funds are almost always combined for investment purposes (sometimes with non-endowment funds), each one must be accounted for separately. This is often referred to as “fund accounting” or “fund tracking”. The items to be tracked include gifts made to each fund, its pro-rata share of investment gains and losses, and distributions made each year. In this way, the balance of the endowed fund is tracked from year to year, an essential component in determining the proper amount of distributions to be made.

How extensively fund accounting will be applied depends upon the charity. At a minimum, the general (unrestricted) endowment fund must be tracked. Any endowment funds organized along programmatic lines will also need to be tracked separately. The best – and most common practice – is to track these balances at the aggregate level within each fund. For example, in year one the Outreach and Education Endowment Fund receives three gifts of $200 each, two gifts of $500 each, and one gift of $10,000. While a summary of the individual gifts and who made them should continue to exist somewhere in the charity’s records, for fund tracking purposes the key number at the end of year one is $11,600.

- **Area of Interest Funds**
  If named endowed funds are accepted by the charity, it must decide if it will track each of these funds separately. Some organizations, most often those heavily dependent on volunteers, decide that this would be too complex for their organization and offer such funds basically in name only. A donor can establish a named fund that will be reflected separately in donor recognition materials but changes in the fund balance will not be tracked over time. It is particularly important in this situation to offer some programmatic endowment funds so that donors have a way to direct the purpose of their gift. This cannot be done on an individual basis since individual balances are not known.

- **Fund Tracking**
  More frequently when offering named endowed funds, a charity will agree to account for each fund separately, tracking beginning balances each year, adding and subtracting investment gains and losses, as well as distributions. This is the preferred practice as it has greater appeal to donors and will be more satisfying to them over time. While there is more administrative work involved in this approach, it will result in more gifts to endowment, from both new donors and donors interested in adding to “their” existing funds.

  Advocacy for this approach is made easier if it is the planned giving office that will be responsible for tracking fund balances. For smaller programs this can be handled through the use of an Excel spreadsheet. If instead the tracking will be done by the


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finance office, the planned giving office can be helpful by explaining the conceptual framework of the various funds, setting reasonable minimum funding levels that justify the administrative effort, and assisting in the evaluation of endowment tracking software and/or services. (It also helps to assure the finance office that the least restrictive possible gift arrangement will be pursued first with each donor).

It may be that the financial institution managing the investment of the endowment funds will be willing to do fund accounting for the charity, at little or no cost. In addition, there are third-party vendors – including PG Calc – that can provide this service.

**3. Endowment Investing**

Investment of the endowment is most often done under the auspices of the finance office, with oversight by the Investment Committee of the charity's Board. However, this does not mean that development has no role to play. A strong development office will work with the finance office to make sure that investments are being handled in a way that meets the existing standard of care and represents good stewardship of the donors' gifts. If endowment falls within the purview of planned giving generally, this function will as well.

On a secondary note, it is also important for development officers to have a basic understanding of how endowment funds are invested for purposes of sharing that information with endowment prospects and donors.

## IV. The Overlap Between Endowment and Planned Giving

There are characteristics that are common to both planned gifts and endowment gifts. Understanding these similarities will help with understanding how a planned giving program can help build endowment.

### A. The Notion of a Legacy

It is estimated that 75 percent to 80 percent of planned gifts are bequests. With newer, less developed planned giving programs, this percentage can be even higher. Inherent in a bequest is the desire to make one last gift in support of a cause or activity that the donor found important and compelling during his or her lifetime, coupled with a desire to ensure the charity's purpose is continued once the donor is no longer living. In addition, a deferred gift of any kind – bequest, beneficiary designation of retirement assets, proceeds from an insurance policy – gives the donor an opportunity to establish a legacy, to leave "…footprints in the sands of time". These same sentiments of being remembered and having a long-term impact also motivate gifts to endowment. The desire to leave a personal imprint, either for oneself or a loved one, is met particularly well by the creation of individual, named endowed funds.

### B. Long-term Stability for a Charity

Endowments are a long-term proposition, by their very nature concerned with the long-term viability of a charity. Similarly, deferred planned gifts have a long-term aspect to them.

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While the gift is arranged now, the donor realizes that the support it provides will not be realized until sometime in the future. A belief in the long-term continuance of the charity, and a desire to help ensure that future, is a key part of many, if not all, deferred gifts.

### C. A Focus on Assets

Planned gifts are typically made out of assets rather than current income. When donors are giving wealth that they have slowly accumulated over years or decades, it can be especially appealing to make that gift in a form devoted to the fulfillment of charitable purposes for years, decades, and even centuries.

### D. A Focus on Individuals

Even though foundations and corporations sometimes make grants for endowment purposes, this is fairly rare. To be successful, a charity's emphasis should be placed on individuals. Planned giving by its very nature has a similar focus on individuals.

### E. Planned Giving as a Catalyst for Change

For the reasons above, the support and encouragement of endowment does not really happen at some charities until there is an active planned giving program. Sometimes the question of whether to have an endowment arises as part of the discussion about the types of gifts contemplated in the planned giving program. Will gifts to endowment be among the gift options offered? The adoption of gift acceptance policies driven by having a planned giving program often raises the question of having a similar policy concerning endowment.

Sometimes the planned giving program provides a "home" for endowment. It is not uncommon for the development officers responsible for planned giving also to be charged with directing, or at least assisting, endowment efforts.

## V. Strategies to Build Endowment Through Planned Giving

### A. Deferred Gifts to Endowment

The most direct way a planned giving program can help build a charity's endowment is through the allocation of matured unrestricted deferred gifts to the endowment. Whether or not to do this is a key policy decision that every charity should make, preferably prior to the receipt of the first large unrestricted deferred gift! Making this a matter of policy is essential to ensuring that the organization has the strength and resolve to put these gifts aside when they come in.

Deferred gifts are, by their very nature, almost always uncertain as to their timing and/or the actual amount received. Because of this, they are often not built into the annual operating budget, and are in a certain respect "extra" funds. To allocate these dollars to endowment may be the least painful way for a charity to increase its endowment over time. Charities that do include a given level of deferred gifts in each year's budget, based on past years' experience, can decide to place any deferred dollars above the budgeted amount into

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endowment. Obviously, the stronger the planned giving program, the more quickly the endowment will grow through this approach.

Charities run the gamut on this issue. Where the financial situation is not as stable as desired or where there is lukewarm support for the endowment, no deferred gifts are automatically directed to endowment. Rather, gifts – or more likely, gifts over a certain dollar amount – are individually evaluated at the time received. Other charities state that the first $XX dollars of each deferred gift will go to the operating budget, with dollars above that amount directed to the endowment. In organizations where the capacity and desire to increase endowment is the greatest, the decision has been made for all unrestricted deferred gifts to be placed into endowment automatically, regardless of size.

In these situations, it is actually the quasi-endowment that is growing because it is the Board that directs these gifts to endowment. However, the true endowment can grow through the allocation of planned gifts as well. This would be the case where a charity has a policy of asking donors to direct their otherwise unspecified deferred gift to endowment. One charity's default purpose statement for its gift annuity agreements reads "The remaining balance shall be used for the general endowment". Although the designation to endowment results from a deliberate policy adopted by the charity, it is true endowment because the donor specifies in the gift instrument that the gift be used for endowment.

## B. Endowment Promotion

Endowment often finds a marketing "home" with planned giving, which is all about offering choices to donors. Discussing a gift to endowment is a natural fit, as one more way among many to support the charity and achieve personal goals as well. A charity should include mentions of endowment giving in all areas of planned giving promotion: e.g., a section within the "Ways to Give" brochure, donor stories, articles, inserts, and the planned giving section of the website. If endowment is covered elsewhere in the development pages, include a brief description on the planned giving page(s) with a link to the larger endowment section. If resources are available, develop a separate brochure for endowment giving to complement other specialized gift-type brochures.

Incorporate the idea of endowment into ongoing planned gift discussions. Often it will be a natural fit in conversations with donors about the legacy they would like to leave. This will not only result in more gifts to endowment but can be a good way to introduce the subject of a deferred gift. For example, the development officer might say something like:

> "Sam, you have been a faithful contributor to ABC Charity for many years. Have you ever considered endowing your gift? For example, if you were to provide for a $25,000 bequest in your will, you could assure that income of $1,000 per year, or possibly more, would continue in perpetuity in your name."

or

> "Alice, you have given an average of $500 a year to us over the past twenty years. Have you ever thought about establishing an endowment fund with a gift


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through your will? With a bequest of $15,000, you could ensure that your same level of support will continue even after you are gone. The fund could be named for you and your husband and create a permanent legacy at ABC Charity."

Sometimes donors are interested simply in making a permanent impact with their gift. For them, gifts to general endowment (or a programmatic endowment fund) will be sufficient. For others, it will also be important to be remembered far into the future. For such donors, providing the option of named endowed funds will make a deferred gift much more likely.

By raising this linkage when appropriate, more deferred gifts will be arranged and more funds will flow into endowment.

### C. Creative Gift Arrangements

Those working in planned giving are used to thinking in creative ways to design gifts to meet the needs of the donor as well as the organization. This creativity can be applied to the realm of endowment as well.

- **Virtual Endowment**
  This is essentially a pledge of an annual gift for life coupled with a large bequest at the donor's death to establish the endowment permanently. The annual gift is akin to the yearly distributions made from endowment, where the endowment principal remains with the donor for life and is then given to the charity at death. This is for donors with relatively high cash flow but not a lot of available liquid assets or who are reluctant to relinquish control over these assets.

- **Amortized Endowment**
  The donor agrees to a term pledge for an annual amount that consists of both an income component (spendable by the charity) and a principal component (retained by the charity). At the end of the term, the accumulated "principal" payments constitute the donor's endowment balance. This arrangement is also for donors with relatively high cash flow but not a lot of available liquid assets.

### D. Endowment Stewardship

A specific role for planned giving is to consider including current (outright gift) endowment donors as members of its Legacy Society. Some charities have found it to be a very good fit to include endowment donors.

Endowment donors overlap with deferred gift donors with regard to the legacy nature of their gift (after all, endowed funds last forever) and a strong desire to ensure that the charity has the financial means to continue beyond their lifetime. Because of commonalities like these, stewardship through the Legacy Society may be more meaningful to endowment donors than the usual outright donor recognition channels. A charity could include all endowment donors in the Legacy Society. However, this number may be too great and include the more 'casual' endowment donor. Instead, consider extending membership only to those establishing named endowed funds and/or those making endowment gifts above a certain size.


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In addition to this consideration, basic endowment stewardship considerations are important. Good stewardship has two parts: 1) ensuring that endowment funds are expended *and* expended on what they are supposed to be used for, and 2) reporting on a regular basis about this usage to the endowment donor and/or their loved ones. If this is done, trust will be established among donors and prospects that their gifts will be used as directed and make a difference, and the emotional ties between donors and their funds will be deepened. All are critical elements for building the endowment over time.

As hard as it may be to believe, endowment distributions sometimes languish unspent in operating accounts. Even if a department or program is using its endowment distributions each year, they are sometimes spent inappropriately. This may be the case due to ignorance, different legitimate interpretations of the stated purpose, or, on that rare occasion, a somewhat more conscious redirection. Correcting the situation may be accomplished by something as simple as providing a copy of the endowment gift agreement to the (possibly new) program person. Other times, a more active advocacy of the donor desire is necessary.

Ideally, endowment reporting will be done on an annual basis and have two components: 1) a report of the overall endowment fund, with consolidated financial information, and 2) a report relaying the status of the individual endowed fund. This report is a snapshot in time and should be kept relatively simple (one page will do). It should include the name of the fund, its stated purpose, how the distribution was used/will be used for the reporting period, and a financial accounting of the fund: beginning balance, investment gains/losses, distributions made, and the ending balance (which becomes next year's beginning balance). It can be supplemented with more information regarding the use of the distribution, e.g., background of a scholarship recipient, if not provided previously. See a sample endowment report in the Appendix.

## VI. Summary

The first decision a charity must make is whether to have an endowment at all, or whether one or more of the endowment alternatives would be more appropriate. Once an organization has decided that an endowment is a good fit, both with its mission and its donors, one way for it to help the endowment grow over time is to establish (or strengthen) a planned giving program. This is true for several reasons:

1) Deferred gifts can be a less painful way for a charity to divert to endowment what would otherwise be current operating resources.

2) The marketing and promotion of endowment gifts fits well with that of planned gifts, since they both address donor desires to leave a permanent mark on the world and to provide support to the charity after they have passed on.

3) A planned giving program can provide a structure within which endowment gifts are systematically encouraged, managed, and stewarded.

Charities should take advantage of the natural synergy between planned gifts and endowment gifts – by increasing the former, the latter will grow as well.


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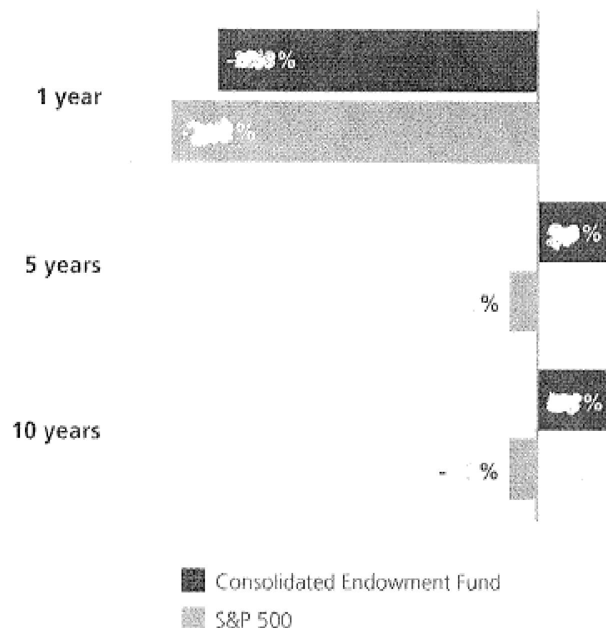
# *VII. Appendix*

## CONSOLIDATED ENDOWMENT FUND PERFORMANCE
## Fiscal Year Ending June 30, 2009

The financial crisis that shook capital markets worldwide left its impact on the CEF. Performance was down - -% in fiscal year 2009. Although dissatisfied with the results, the Board set liquidity as its top priority and the investment team moved swiftly to defensively reposition the portfolio and actively reduce risk. These actions mitigated to some extent the damage wrought by the severe market conditions and positioned the CEF for future recovery.




In light of the 2008-2009 financial crisis and subsequent drop in the CEF market value, the Board of Regents proactively adopted an interim spending policy. This policy decreases year over year distributions to campus programs from FY08 levels by 25% in FY09 and another 25% in FY10. Thereafter, distributions will be held at the reduced FY10 level until market conditions warrant a return to normal spending. The Board will determine the appropriate next steps no later than June 30, 2013.

The CEF is designed to provide support to the University in perpetuity. This long term horizon, combined with prudent asset management and spending policy positions the CEF to recover over time. The University remains committed to the mission of the CEF, supporting current and future generations of scholars.

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### FOR MORE INFORMATION

The full report on the Consolidated Endowment Fund may be found online at uwfoundation.org/cef

For endowment related questions, please contact the University of Washington Stewardship and Donor Recognition Office:

Director, Stewardship and Donor Recognition
@u.washington.edu
(206) 543-

For questions regarding market performance or investment practices, please contact the University of Washington Treasury Office:

Associate Treasurer, Operations and Investor Relations
@u.washington.edu
(206) 616-


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Consolidated Endowment Fund Report for

## Mr. & Mrs. John and Jane Sample

Fiscal Year Ending June 30, 2009

Fund Name: Class of 1941 Endowed Scholarship Fund
Department: Student Financial Aid
Year Established: 1995
Purpose: To provide scholarships to undergraduate students with academic merit and demonstrated financial need.

| Fund Principal Activity | | | Distributions[2] | |
|---|---|---|---|---|
| | Contributions | Market Value | | |
| 6/30/08 Balances: | $85,220 | $199,808 | FY2009 Distributions to Programs: | $6,767 |
| Additions:[1] | $0 | | FY2010 Projected Distributions:[3] | $5,075 |
| 6/30/09 Balances: | $85,220 | $144,704 | | |

Fund Name: Judson Falknor Endowed Professorship in Law
Department: Law School
Year Established: 1990
Purpose: To enhance the University's ability to attract and retain distinguished faculty in the School of Law.

| Fund Principal Activity | | | Distributions[2] | |
|---|---|---|---|---|
| | Contributions | Market Value | | |
| 6/30/08 Balances: | $324,253 | $703,350 | FY2009 Distributions to Programs: | $23,821 |
| Additions:[1] | $0 | | FY2010 Projected Distributions:[3] | $17,866 |
| 6/30/09 Balances: | $324,253 | $509,377 | | |

Fund Name: Milton Katims Viola Scholarship
Department: School of Music
Year Established: 1994
Purpose: To provide scholarship support for students studying viola.

| Fund Principal Activity | | | Distributions[2] | |
|---|---|---|---|---|
| | Contributions | Market Value | | |
| 6/30/08 Balances: | $29,115 | $64,370 | FY2009 Distributions to Programs: | $2,180 |
| Additions:[1] | $0 | | FY2010 Projected Distributions:[3] | $1,635 |
| 6/30/09 Balances: | $29,115 | $46,618 | | |


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