

# **Should your non-profit build an Endowment?**

**Massachusetts Land Trust Coalition**

**Matt Goward - February 29th 2024**

# Agenda

- Endowment overview
  - What is an Endowment?
  - Types of Endowments
- Considerations for establishing an Endowment
  - Pros & Cons
  - Financial considerations and relevant policies
  - Governance best practices
- UPMIFA Review
- How to write an IPS for your Endowment
- Board Designated funds

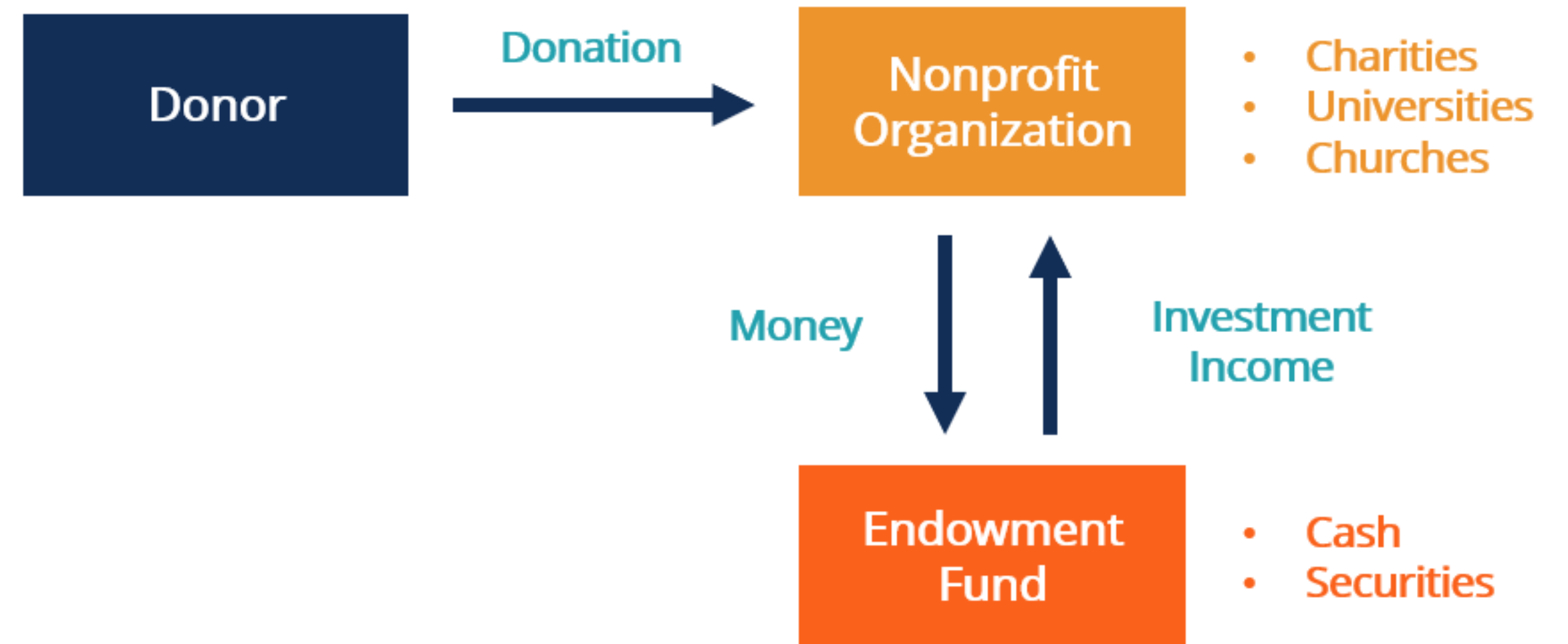
# What is an Endowment ?

An Endowment is a fund, created by a financial gift, where the principal gift is kept intact and income from the fund is available to support the beneficiary organization.

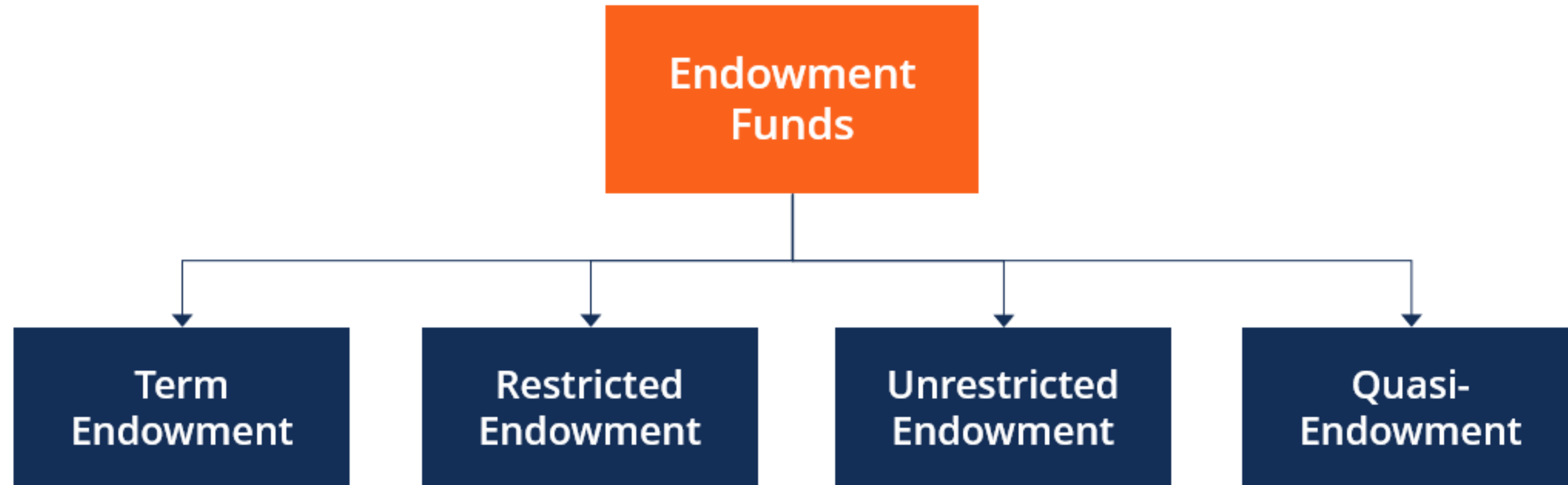
Endowments may be seeded with funds gifted from donors or designated by an organizations Board.

Endowment is a legal term which implies all, or a portion of the endowed assets may restricted in some capacity.

There are four common types of Endowments



# Types of Endowments



Endowments are structured with their principal reserved and not available for daily use. The level of restriction on the principal gift, and the potential use of income earned by the fund differs based on the type of Endowment.

# Term Endowment

- A Term Endowment is a fund where income may be taken annually, with the principal gift being restricted until a certain time or occurrence.
- The term or the triggering event is pre-determined in the fund policy according to the donor's intent.
- At the term-end, the fund becomes an Unrestricted Endowment.
- Term Endowments are not common.

# Restricted Endowment

- A Restricted Endowment is a permanent fund where income may be taken annually, and used to support a specific cause as indicated by the donor.
- A donor makes clear their intention is the long-term support of a specific program or policy.
- A common example would be a scholarship fund, where a donor makes a gift to an Endowment which may only serve to pay scholarships to students with certain academic achievements or backgrounds.

# Unrestricted Endowment

- An Unrestricted Endowment is a permanent fund where income may be taken annually, and used in general support of a beneficiary organization.
- There is no restriction placed by the donor on how the organization may spend the income.
- Unrestricted Endowments are quite common and are usually built through specific fundraising campaigns, where an organization approaches donors with the express intent of creating an Endowment fund.
- Capital campaign example: \_\_\_\_\_ Land Trust outlined the need to establish an endowment in our 2015-2020 Strategic Plan in order to create financial sustainability and continue to support our mission. Our goal is to raise \$2 million by the end of 2020. In 2017, we received our first gift of \$75,000 from a generous, anonymous donor to launch the endowment fund. Please help \_\_\_\_\_ Land Trust continue to build long-term financial support through a donation! Both direct donations and planned gifts can be contributed towards the endowment. [\(See example\)](#)

# Quasi-Endowment

- A quasi-endowment, commonly referred to as a “Board designated” Endowment fund works as a typical endowment does. These are funds designated by Board vote for the express purpose of creating an Endowment Fund.
- Similar to an Unrestricted Endowment the use of funds can be determined by the governing board of the organization that the fund serves. Income from the fund is available annually.
- The major difference between this type of Endowment and the others is that principal may be spent in accordance with the funds policies.
- Usage and withdrawal restrictions may exist in a Quasi-Endowment fund, but the board can end the restrictions for any reason and use the money for any purpose at any time. Compared with typical endowment funds, a Quasi-Endowment offers more flexibility to an organization



# What are the benefits?

- The income from an Endowment may help create stability and predicability. Providing you organization with a steady source of funds towards an ongoing need.
- Over time, the returns on investment can add up to a substantial amount of funding (see example).
- May lessen the impact of changing business cycles.
- A non-profit Endowment can build trust with donors, volunteers and staff. The message sent to the community can be one of strength.
- Provides donors a way to create a legacy. (See example)



# ENDOWMENT CALCULATOR

Years Invested	Your Fund's Annual Growth	Cumulative Growth Before Grants & Fees	Grant Dollars Available Annually From Your Fund	Grant Dollars Available Cumulatively From Your Fund	Your Fund's Net Value (After Annual Grants & Fees)
1	\$7,000.00	\$7,000.00	\$5,000.00	\$5,000.00	\$100,500.00
2	\$7,035.00	\$14,035.00	\$5,025.00	\$10,025.00	\$101,002.50
3	\$7,070.18	\$21,105.18	\$5,050.13	\$15,075.13	\$101,507.51
4	\$7,105.53	\$28,210.70	\$5,075.38	\$20,150.50	\$102,015.05
5	\$7,141.05	\$35,351.75	\$5,100.75	\$25,251.25	\$102,525.13
6	\$7,176.76	\$42,528.51	\$5,126.26	\$30,377.51	\$103,037.75
7	\$7,212.64	\$49,741.16	\$5,151.89	\$35,529.40	\$103,552.94
8	\$7,248.71	\$56,989.86	\$5,177.65	\$40,707.04	\$104,070.70
9	\$7,284.95	\$64,274.81	\$5,203.54	\$45,910.58	\$104,591.06
10	\$7,321.37	\$71,596.18	\$5,229.55	\$51,140.13	\$105,114.01

Projections assume annual return of **7%**, supporting fees of **1.00%** and an annual distribution rate of **4.0%**.

# What are the drawbacks?

- Depending on the type of Endowment, your ability to spend funds may be limited to the income.
- Written consent or a court order may be needed to invade principal.
- There is a need for volunteer and staff education.
- Requires coordination between your budget, chart of accounts, balance sheet and P&L.
- Fundraising for an Endowment may negatively impact your annual giving campaign.



# Financial Ratios

These measures serve as helpful barometers when accessing your financial position

- ***Operating Reserve:*** Measures how long your nonprofit's operating expenses would be covered just by the amount you have in your reserves. The minimum suggested ratio is 25% (or 3-months).
- ***Fundraising Efficiency Ratio:*** Measures the amount of money generated compared to the amount of money spent to raise it. This provides a high-level view of the return on investment for your organization's fundraising campaigns.
- ***Working Capital Ratio:*** Measures the short-term financial health of the organization by comparing current asset to current liabilities.
- ***Operating Margin:*** Measures your organization's ability to produce a potential financial surplus by comparing total revenue to total expenses

# Relevant Policies

## Endowment funds are subject to the following policies

- Investment Policy
  - The investment policy statement outlines the funds asset allocation, risk level, targeted return, any limitations along with general management and evaluation of the fund. ([See example](#)).
- Spending Policy
  - The Spending Policy outlines the amount of money that is available to be withdrawn annually. This is usually stated as a percentage. The percentage is usually low, so that the fund will be able to last in perpetuity. [Questions for the Board](#)
- Usage Policy
  - The Usage policy determines what purposes a fund can be used for.

# Governance

## Best practices or Boards and Investment Committees

- Articulate the organizations long-term objectives and unique needs.
- Realistically evaluate the organizations resources, and recommend the appropriate governance and operation framework.
- Establish a clear, detail oriented IPS and finding the appropriate person to manage the investment portfolio.
- Coordinating within the organization to ensure a cohesive understanding of your Endowments purpose.
- Greenwich Roundtable

# Understanding the rules

## **(UPMIFA) Uniform Prudent Management of Institutional Funds Act**

- (UMIFA), released in 1972, created the first universal guidance for how non-profits should sustain their endowments.
  - The Act required endowments to keep pace with inflation and created the “historic dollar value,” which reflects the fair value of the fund when received, subsequent gifts to the fund and donor expectations for the fund.
  - Non-profits could appropriate interests and dividends that exceeded the fund's historic dollar value. However if the fund ever decreased below its historic dollar value, appropriations from the fund were stopped until the historic dollar value was restored.
- In 2006, the Uniform Prudent Management of Institutional Funds Act replaced the prior guidance. UPMIFA moved away from historic dollar value and toward an endowment management approach that focused on preservation of the fund. It established specific criteria which must be followed.

# UPMIFA Factors “Prudence Standard”

1. Prudent management
2. Duration & preservation of the fund
3. Charitable purpose
4. General economic conditions
5. The needs of the fund to make distributions and preserve capital
6. Effect of inflation or deflation
7. An institution shall diversify the investments of the fund
8. The role that each investment plays within the overall portfolio
9. Expected total return from income and appreciation
10. Organizational resources



# UPMIFA - Key Takeaways

1. Determine if UPMIFA applies,
2. Evaluate your current policies against the factors outlined by UPMIFA
3. Interconnectivity - Your policies and approach to soliciting for your Endowment all need to inform one and other
4. Document your polices and establish a process for ongoing review
5. See [Endowments UPMIFA and why it matters](#)



# How to write an effective IPS

- An effective IPS should include the following provisions:
  - Purpose
  - Definition of Duties
  - Objectives
  - Asset Allocation
  - Rebalancing
  - Spending Policy
  - Risk Management
  - Limitations and Responsible Investing
  - Monitoring and Review Process
- An IPS should cover the following fund structures
  - Any Reserve funds, Board Designated funds and Endowment funds ([see example](#))
- [Elements of an IPS, full text](#)

# Board Designated Funds

## Board Designated, Endowment & Non-Endowment funds

- Responsible stewardship requires having resources available to monitor owned land, as well as easements, and take effective action if problems emerge.
- A common capital structure includes:
  - **Stewardship Fund** - Supports the non-legal costs for stewardship of our easements and fee owned properties, including (but not limited to) staff time, monitor training, supplies, record storage, and maintenance of our properties.
  - **Enforcement Fund** - supports the legal defense of any of our easements. It can be used either for mediation or court costs or for legal and professional services to resolve compliance issues.
  - **Quasi-Endowment** - finance special opportunities as they arise or to address temporary funding shortfalls.

# Board Designated Funds

## Board Designated, Endowment & Non-Endowment funds

General bequest:

“I give, devise, and bequeath to the \_\_\_\_\_ Land Preservation Trust, a non-profit organization, with its office at \_\_\_\_\_ the sum of \$\_\_\_\_\_, to be used for its general purposes.”

Specific bequest:

“I give, devise, and bequeath to the \_\_\_\_\_ Land Preservation Trust, a non-profit organization, with its office at \_\_\_\_\_, \_\_\_\_\_(describe any real or personal property), to be used for its general purposes.”

Residuary bequests:

“I give, devise, and bequeath to the \_\_\_\_\_ Land Preservation Trust, a non-profit organization with its office at \_\_\_\_\_, all (or \_\_\_%) of the rest, residue and remainder of my estate, to be used for its general purposes.”

Contingent bequests:

“If \_\_\_\_\_ predeceases me or disclaims any interest in \_\_\_\_\_, I hereby bequeath his or her share to the \_\_\_\_\_ Land Preservation Trust, a non-profit organization, with its office at \_\_\_\_\_, to be used for its general purposes.”

# Resources

## Helpful links on relevant topics

- [Donation page example](#)
- [Stewardship costs](#)
- [Non-Profit Budgeting: Understanding the Basics](#)
- [Restricted Funds](#)

