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Endowments: Dipping in During Emergencies

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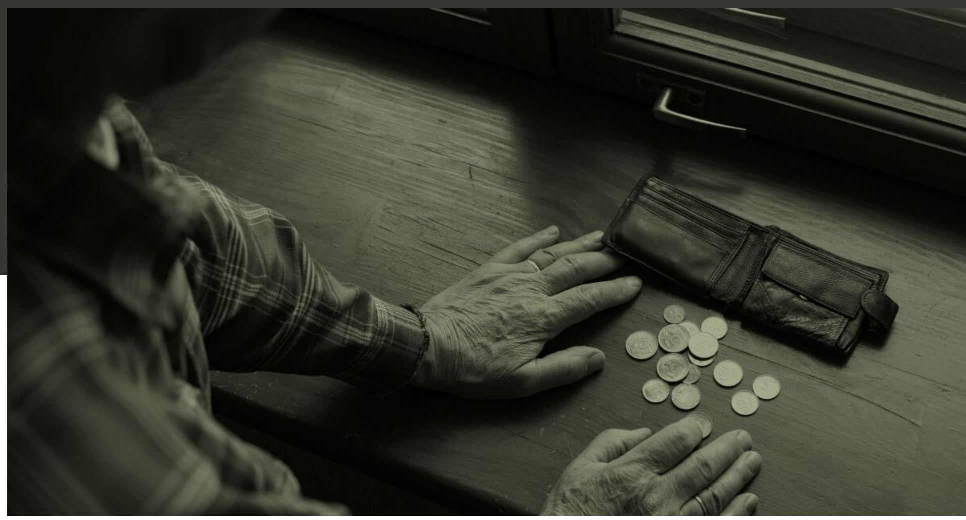

"The COVID-19 pandemic has wreaked havoc on the finances of a broad swath of the nonprofit sector," we wrote last summer in *Diverting Restricted Funds During A Crisis*.

Dependable sources of revenue evaporated overnight or slowed to a trickle. Many organizations have scrambled for temporary replacement income including – wherever possible – *virtual* fundraisers and programs.

For directors and senior staff of those organizations in the enviable position of having endowments, there are now whispers of a once taboo topic: how to untie and dip into these restricted funds.

"True" Endowments

Much of our post from last August focused on a problematic threshold issue: confusing and sometimes incorrect terminology.

What many in the philanthropic community call an "endowment" or an "endowed" fund may not be a "true" endowment. Similarly, what they refer to as a "restricted" gift may sometimes be a mere *board-designated* (instead of donor-designated) restriction. In that situation, the condition or limitation can generally be lifted by the board quickly and easily with a simple vote.

In this post, we focus on "true" endowments and how to go about tapping into them in dire circumstances like the COVID-19 pandemic and the related stay-at-home orders and widespread shutdowns.

What is a "true" endowment? Erik Dryburgh, Esq., of San Francisco's Adler & Colvin, helps out with this description in *The Law of Endowments – The Uniform Prudent Management of Institutional Funds Act (UPMIFA)* (December 2017). "To a donor," he explains, "an endowment is a sum of money given to a charity for charitable purposes, with only the 'income' being spent and 'principal' being preserved." He continues: "To an accountant, it is a fund which is 'permanently restricted.'" And, finally, Mr. Dryburgh adds: "To a lawyer, it is an institutional fund not wholly expendable on a current basis under the terms of the gift instrument."

More simply put (courtesy of the National Council of Nonprofits): Endowments are "… assets (usually cash accounts that are invested in equities or bonds, or other investment vehicles) set aside so that the original assets (known as the 'corpus') grow over time as a result of income earned from interest on the underlying invested funds. The corpus may also be added to over time."

In other words, it's an asset generally "held for a particular duration" (either a term of years or "in perpetuity") and may be used either generally for the organization's mission or otherwise for specific restricted purposes only. *Using Endowed Funds in a Crisis: Key Considerations* (May 8, 2020) Douglas K. Anning, Esq. et al, Polsinelli LLP

In some endowments, all of the principal is set aside; the donee-organization is permitted to use income only. In others, a certain amount of principal may be used annually or from time to time.

While (true) endowments are most commonly found in large charitable or community institutions, there is no minimum amount required and this type of funding vehicle may be a good fit for medium-sized or even smaller organizations.

Whether the terms or use of an endowment with tight restrictions may be lifted or temporarily eased depends on: (1) the gift instrument that created it; and (2) governing state law.

Endowment Gift Instruments

Under the Uniform Prudent Management of Institutional Funds Act (UPMIFA) – (we'll explain that more in the next section) – there must at least be a "gift instrument" in writing. Most donors don't hand over huge pots of money without some kind of formal documentation. Then again, some do. That's why there are laws mandating minimum requirements.

UPMIFA "defines a gift instrument as a 'record' – information inscribed on a tangible medium or stored electronically – including an institutional solicitation, under which property is given." While a detailed document is best, even an email or a memo line in a check will satisfy the minimum requirement under UPMIFA.

"[A]ny donor restrictions that use the word 'endowment' are considered to create a fund of permanent duration unless other language in the gift instrument limits the duration of the fund." How a donee-organization may use an endowment is also generally controlled by the gift-instrument language. Bear in mind, though, that where an endowment restricts funds "to a particular use," it must be used solely for that purpose. That includes funds drawn from an endowment pursuant to consent or other specified permission in extraordinary circumstances. "Thus, the ability to invade an endowment may not necessarily solve the strain caused by the current crisis."

The best practice is, of course, to have a formal and detailed gift instrument. It should include a specific clause explaining if, how, and under what circumstances, any of the restrictions can be changed or at least eased temporarily. Specifically, the written gift instrument should expressly authorize the donor simply to consent in writing to a modification – and detail as well how that consent should be obtained and documented. In addition, the instrument should spell out an alternate procedure for the donee-organization to follow to obtain official approval or consent for a modification with or without going into court.

Endowments Under State Law

If there is no provision in the gift instrument for donor consent or modification either under ordinary circumstances or in the event of emergencies (or for an alternate procedure to follow), then state law comes into play.

Let's back up for a minute and review how complex statutes are sometimes drafted around the United States. State legislators generally have a lot on their plates and are called upon to pass statutes that range from relatively simple matters to complicated rules for a wide variety of technical and complicated transactions. That's where it helps to have experts carefully mull over and draft proposed legislation for each state's lawmakers to consider and hopefully adopt in whole or at least in substantial part. The National Conference of Commissioners on Uniform State Laws is the body that writes these "standard" laws. They are usually titled "Model Blah Blah Blah Act" or "Uniform Blah Blah Blah Act."

In 1972, these commissioners drafted the Uniform Management of Institutional Funds Act (UMIFA). It was approved and adopted all around the United States in one form or another. The purpose was to set out the governing rules for charitable endowments: how to manage and invest them, and under what circumstances these funds may be modified. In 2006, UMIFA was updated and replaced by the commissioners with the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The inclusion of the word "prudent" in the new title gives a clue about how and why UMIFA needed revision. Since then, almost all U.S. jurisdictions have enacted an exact or substantially similar version of UPMIFA.

UPMIFA specifically authorizes endowment "written gift instruments" to include clauses on donor consent as well as provisions for an alternate procedure to get official approval of a change.

In the event there are no such donor-consent or alternate-procedure clauses in a written gift instrument, then UPMIFA spells out the process by which — in certain limited circumstances – the donee-organization make seek and obtain consent for a change. UPMIFA allows groups with smaller and older endowments to make some changes without going into court.

California, Other States

California adopted its version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in early 2009. See California Probate Code sections 18506(a) – (d). It governs endowments created on and after that date as well as retroactively in the case of pre-2009 endowments.

In May 2020, the California Attorney General's Office issued a helpful booklet titled *Charity Governance During the COVID-19 Pandemic* including a section on "Modification of Endowment

Funds to Tackle Emergencies." See also Erik Dryburgh's excellent explanations and summaries from his 2017 article, *The Law of Endowments – The Uniform Prudent Management of Institutional Funds Act (UPMIFA).*

Specifically, California's UPMIFA statute defers to an endowment's governing instrument providing for donor consent or other specific procedure for gaining official approval for a modification. It also includes UPMIFA's exception to the usual requirement of court approval of modifications for endowment funds created more than 20 years ago and with a current value of less than $100,000.

In all other cases, UPMIFA sets out a procedure for the donee-organization to go into court for official approval for a modification in circumstances including ones "not anticipated by the donor" or if a restriction has become "unlawful, impracticable, impossible to achieve, or wasteful…."

In places other than California, the UPMIFA statutes are similar. For instance, see Colorado (link) and Arizona (link). These statutes are easily found with a simple Google search: Type in "Uniform Prudent Management of Institutional Funds Act" plus the name of the jurisdiction.

Conclusion

Building flexibility into endowment funds is not not a novel or radical act. It should be the norm instead of the exception going forward.

The modern trend in charitable giving is to move away from "perpetuity" and ironclad restrictions in favor of more adaptable arrangements. It's also become popular for private foundations; see our recent post, *A Sunsetting Tale* (September 23, 2020). There, we mentioned tycoon-philanthropist John D. Rockefeller's observation over a century ago: "Perpetuity is a very long time."

— Linda J. Rosenthal, J.D., FPLG Information & Research Director