Big Sky Institute for the Advancement of Nonprofits

Building Montana's Communities Through Strengthening Nonprofits and Expanding Philanthropy

Endowment Development - Helena Development Roundtable – 2/4/14

Presented by William B. Pratt, projects coordinator, Big Sky Institute for the Advancement of Nonprofits; formerly development director, Community Foundation of the Inland Northwest & program director, Montana Community Foundation

Why to create an endowment.

- organizational stability – 3rd leg of the development triangle (annual contributions, earned income, % of assets)
- reinforces organization's businesslike, future-looking approach and concern for sustainability
- addresses donor needs and charitable intent; desire for recognition, or anonymity
- access contributions from assets that might be otherwise unavailable
- often used in conjunction with a capital fund drive

Which organizations should create an endowment?

- established nonprofit organizations
- annually financially stable/ adequate cash reserves
- continual capacity to engage in endowment development to create multiple-decade gift pipeline
- sufficient major donor base (Frequency of giving, Longevity of giving, Age, and Gender)

What is an endowment?

- **True endowment –**
  - established by a donor (individual, foundation, corporation, trust, various business entities, etc.)
  - permanent fund or one established for a term of years
  - for general or specific purposes
  - not cash reserve

- **Quasi-endowment/board-established endowment/fund functioning as an endowment**
  - created by board from undesignated gift, income stream, "excess" cash
  - basically, a reserve that may be kept in cash or invested
  - non-permanent fund, which can be dissolved by the current or future board
  - general or specific purposes

Suggested Board Actions

- resolution establishing desire to accept endowment gifts and for what purpose (general support, major program components, etc.)
- possible bylaw change allowing acceptance of endowed funds

- gift acceptance policy (if org. does not already have one), also minimum gift to establish a named fund, e.g., $10,000 or otherwise it goes into general endowment.
- Investment policy (who invests, how they invest, independent evaluation, asset balance, etc.)

Investing the Endowment

- long-term investment, employing modern portfolio theory (multiple assets) in accordance with state and federal law, (MCA 72-30-101 to 102 and 202-212. Uniform Prudent Management of Institutional Funds Act)
- board has expertise, prudent investor rule, no self-dealing or conflict of interest, possible use of low cost asset allocation funds
- contract with professional investment management – not just your local broker- someone experienced in institutional investment; may require a high minimum investment
- use third party expertise to monitor investment performance and recommend management change/ assets acquisition.
- contribute to community foundation (on permanent basis) to create an agency fund and take advantage of commingled funds, professional investment, planned giving services, 3rd party protection; Note: can make a quasi-endowment into a true endowment, as the nonprofit is the donor. Requires a minimum . contribution. Donors may also establish a designated or donor-advised fund at the foundation that can benefit the nonprofit.

Adding to & withdrawing funds from endowment

- if stock is contributed, it is usually immediately sold, and invested in the asset class (s) of the portfolio necessary to balance the portfolio. For example, if the portfolio is equity heavy, you may need to add to the bond portion, or if it is "growth" heavy, add to "value" equity, in accordance with investment policy
- by MT state law, a nonprofit can take out up to 7% of assets averaged over at least 3 years (usually 12 quarters); the percentage is usually 4-5%, to prevent eroding the corpus of the endowment

Building the endowment

<u>Common wisdom:</u> Endowments are usually built from assets held within an estate and not from a donor's discretionary income, which usually supports annual and capital giving that gives a donor knowledge about the immediate use of funds and recognition Also, estates may provide larger assets and assets that need to "converted" to benefit the donor, as well as to reduce the tax impact of the gift. However, there are exceptions, steeply rising market or low cost basis of securities, unneeded property, lots of assets, challenge grant to leverage gift, special organizational "milestones," or endowment campaigns.

Because of complexities, the donor usually engages professional legal, accounting or investment expertise to "make" the gift, in consultation with the organization's development director. Ensure that the gift truly benefits the organization.

- <u>Bequests and the Legacy Society: The first step</u>
  - the most popular type of planned gift & the first and most important to put in place
  - easy to understand and inexpensive to make
  - very flexible (single or multiple beneficiaries; dollar amount., percentage, specific gift, residual of estate); retirement or nonretirement assets
  - minimal impact on current lifestyle

- revocable, if circumstances/ interests change or dissatisfied with the nonprofit
- Legacy Society – recognizes donors that have made a planned gift of any kind; learning opportunities as well as regular activities that help build relationships.

- Permanent planned gifts (life income gifts): Donor can choose single or multiple beneficiaries. Gift is irrevocable, but beneficiary is not, unless stated in trust agreement.

- Paid-up life insurance: donor makes the charity the owner and beneficiary of the unneeded policy or one purchased specifically for gifting (single premium policy).

- Charitable gift annuities and deferred gift annuities – initial contribution (often $5,000 minimum) – contract with nonprofit; organization responsible for making periodic payments to donor and 2nd beneficiary for their lives. Upon both deaths, the amount remaining in the annuity reverts to the nonprofit.

- Charitable remainder trust (annuity & unitrust): "workhorse" of planned giving; legal trust established, often with greatly appreciated assets, e.g., land tis sold by trust and proceeds are then invested to give life income (either fixed dollar amount or fixed percentage). Can make multiple contributions to a unitrust but not to an annuity trust. Can save income, gift, and/or estate taxes. Also eligible for charitable deduction of the present value of the gift. Avoid capital gains tax.

- Pooled income fund: functions similarly to charitable remainder trust, but is a pool serving many donors making smaller contributions.

- Charitable lead trust (annuity & unitrust): Triggering event; Income from trust immediately benefits nonprofit for a specific number of years; the trust then reverts to donor or heirs.

- Life estate: Donor deeds personal residence or agricultural property to charity and retains a life estate for one or more individuals or for a fixed term of years. A residence need not be the donor´s primary residence. Transfer is not made in trust and may not include personal property.

Montana Endowment Charitable Tax Credit: (See: www.mtnonprofit.org/endowMontana/default.aspx for more details)

Planned Gift - Provides a credit (dollar for dollar reduction) against state income tax liability in the amount of 40% of the present value of any planned gift to a permanent endowment of a Montana charity up to a maximum amount of $10,000 per year per taxpayer. [Applies to individual or business entity taxpayers.]

Outright Gift - Provides a credit against state income tax liability in the amount of 20% of the present value of any outright gift by a business entity to a permanent endowment of a Montana charity up to a maximum of $10,000 per year per taxpayer. [Applies to corporations, small business corporations, partnership or limited liability company taxpayers.]