REGIONS

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Starting an Endowment: Where to Begin?

CREATING A LONG-TERM INVESTMENT POOL TO PROVIDE ONGOING SUPPORT FOR THE FUTURE OF YOUR NONPROFIT.

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The Benefits of Starting an Endowment

Generally speaking, an endowment is an investment fund created to support the long-term needs of an organization. As the endowment grows, the investment proceeds can be used to fund a nonprofit's mission for the coming years and decades.

There are many benefits to establishing an endowment. It marks a key stage in the life cycle of your organization, extending your ability to serve others and achieve your mission. It can also signal to your donors and community that your nonprofit is financially stable and fiscally responsible, that your board is engaged and that you are working to meet current needs while also ensuring your long-term viability.

In addition to communicating to stakeholders inside and outside your organization that you are thinking strategically about the future, here are five potential benefits.

1 Reliable Revenue

Having an investment that can generate a reliable revenue stream year after year lets your organization go beyond the usual sources of revenue—including annual fundraising—in deciding how to fund current and future needs.

2 New Avenues for Donor Support

An endowment fund gives your most dependable supporters a new, lasting way of committing themselves to your mission.

3 A Lifeline During a Downturn

An endowment can support an organization during economic slumps and other times when your finances may be stretched thin.

4 Lasting Support

Knowing that this source of support extends in perpetuity can help your supporters understand that you'll be able to achieve your mission for decades to come.

5 Expansion Opportunities

Because an endowment is designed to grow over time, your organization may be able to go beyond maintaining the status quo and expand your mission.

THREE COMMON TYPES OF ENDOWMENTS

TRUE ENDOWMENT

Funds are set aside and legally restricted to generating income for the nonprofit. Income can be defined broadly to include realized/unrealized capital gains. Principal may not be spent. As an example, a donor may leave a bequest to a nonprofit that specifically provides that the corpus of the gift is to be preserved and that income only is to be used for future capital projects.

QUASI-ENDOWMENT

This is typically created when a board adopts a resolution committing funds for the long-term support of the nonprofit. Because it is created by board resolution (as opposed to a donor restriction), the board may later adopt a resolution removing or changing the self-imposed restriction and allowing principal to be used. Note that the board creating the quasi-endowment can limit the ability of future boards to make changes, such as requiring that future changes be adopted by a supermajority or even requiring board unanimity.

TERM ENDOWMENT

The use of principal is restricted for a specific period of time. For instance, a donor may provide that only the principal of a gift can be used for 10 years to support a certain program and that after the 10 years, the board may use the principal or add it to its quasi-endowment.

What it Takes to Launch an Endowment

Starting and maintaining an endowment can have considerable benefits, but before deciding to launch one, your organization should ask several questions, including the following.

- Is your nonprofit currently on good financial footing? For instance, do you have sufficient operating reserves? Do you have diverse sources of revenue?
- Do you have a strong donor base that is stable or growing?
- Is there consensus among board members and staff that an endowment is needed? The board and staff will play crucial roles in establishing, growing and managing the endowment.

Funding Your Endowment

Although the creation of an endowment can seem like a daunting prospect, there are multiple ways to fund an endowment:

Gifts

Some endowments begin with a foundational gift. A supporter of your nonprofit might bequeath a sizeable sum. Many nonprofits use planned giving to fund their endowment.

Campaigns

Often organizations launch a campaign to provide funding specifically for the endowment. In addition to individual donors, the campaign may seek funding from the philanthropic arms of large corporations or from private foundations.

Selling of Assets

Some nonprofits start an endowment with funds raised through the sale of an asset. For instance, a nonprofit may sell a building and use the cash generated from that transaction to seed the endowment.

Surplus Funds

Should your nonprofit have funds available at the end of the year that are not needed for operating reserves, those funds could be used to fund the endowment.

PRACTICE TIP

Some nonprofits are wary of asking donors to fund an endowment for fear that they will no longer fund current operating needs. To the contrary, a donor who is committed to the future work of the nonprofit will likely want to maintain current giving. In addition, the campaign could include multiple goals with some donations being marked for current use and others for the endowment.

Five Steps for Getting Started

Once you have buy-in from your board and staff and have determined you're on strong financial footing, you can focus on the nuts and bolts of creating an endowment. Five steps to consider:

1 Choose how to structure the endowment.

Determining the appropriate structure for the endowment is a critical step. The two basic ways to structure the endowment are either through a separate account or a separate legal entity.

A Separate Account

An endowment can be created through a separate account within the nonprofit. One of the benefits of this structure is the relative ease for creation of the endowment. The board can adopt a resolution, which is a fairly straightforward document (for more, see "Why a Board Resolution?" on page 5), and open a separate account. The costs are kept to a minimum because the nonprofit is not incurring the expense of creating another legal entity or the associated costs with maintaining that separate entity.

This structure is also flexible, which can be beneficial in that it can later be amended by the

board to reflect the changing needs of your organization. Your donors, though, may want some assurance that the purpose of the endowment and permissible use of the funds will not be materially changed by later board action. Keeping that in mind, the board creating the endowment may want to include language that limits the ability to make future changes. For instance, the board could include a requirement that any changes require the approval of a supermajority of the board or unanimity.

Another consideration is that an endowment housed in a separate account owned by the nonprofit may be subject to legal claims against the nonprofit.

- **A Separate Legal Entity**
  Sometimes an organization will create a separate nonprofit expressly for an endowment. That way, the assets of the endowment will have greater protection from the liability of the working nonprofit. Moreover, as its own legal entity, the endowment will have its own governing board, which can create more board positions for engaging those passionate about your mission. Having a separate board for the endowment can also protect against pressure to use the endowment to meet urgent needs or shift direction of the working nonprofit. Yet, as noted, this approach can be more expensive and involved than a board resolution establishing a separate account.

Engage your legal counsel and accounting expert to ensure that the endowment is appropriately structured to meet the needs of your nonprofit.

WHY A BOARD RESOLUTION?

Establishing an endowment via a resolution by the board could:

- Memorialize the board's commitment to building an endowment to support the future needs of the nonprofit and commit certain gifts, such as planned gifts, to the endowment.
- Require the establishment of a spending policy.
- Establish under what circumstances, if any, funds outside the spending policy could be drawn.

2 Establish a spending policy.

This will guide how and when funds from the endowment can be spent. A spending policy provides a blueprint for meeting your group's needs while ensuring the fund's long-term viability. Spending policies are often set as a percentage (typically 3%–5%) of a rolling 12-quarter average of the fund's value. Having an average looking back over 12 quarters helps establish some stability in terms of spending. By decreasing the spending amount in difficult times, this policy also lessens the strain on the endowment.

FOR MORE ABOUT SPENDING POLICIES, read "Maintaining the Mission: Creating a Nonprofit Spending Policy" on Regions.com.

3 Determine when you'll begin to draw on the endowment.

If you're raising an endowment from scratch, you'll likely want the principal to grow to a certain level before funds can be withdrawn. That level may be based on reaching a certain milestone (e.g., reaching 50% of the total endowment goal) or a specific dollar amount, such as $5 million. The goal may be based on the size of the fund necessary to provide annual proceeds of a certain amount (e.g., if $40,000 in proceeds needed to support a specific program, then a fund of $1 million or more at a 4% spending rate would support that program).

4 Decide on rules for gift acceptance and use.

A gift acceptance policy can lay out what kinds of donations may be accepted by your organization. It also educates the board and staff about potential issues associated with certain gifts. While many donations are made with cash or appreciated public securities, some donors may want to donate land, real estate or fine art, and your gift acceptance policy can set the rules for such gifts. A few examples of these requirements include the need to seek advice of counsel, an environmental assessment of any property and an analysis of the carrying cost of the gift.

A related consideration is the gift agreement, a document that stipulates the terms of a gift and how it will be used. If a donation is intended for a particular purpose, the gift agreement may include language that allows funds to be shifted to another purpose if the original need no longer exists or the circumstances of the nonprofit change.

LEANING ON YOUR PEERS

When considering the establishment of an endowment, it can also be extremely useful to talk with peer organizations about their experiences creating one.

- What were the surprises?
- What lessons have they learned?
- What would they do differently if they had a chance to do it again?

Our knowledgeable associates can connect your organization with other nonprofits, so that you can compare best practices, including spending and gift acceptance policies.

5 Consider how your endowment will be invested.

The success of your endowment largely depends on how its assets are invested. Your board may create a committee responsible for overseeing the endowment, and that committee is likely to choose an outside investment consultant. That consultant will work with you and your committee and/or board to understand the short- and long-term goals of your organization and then to craft an investment policy statement that reflects those goals. The policy and the resulting portfolio will be customized to fit your nonprofit's need for return and risk tolerance and will be designed to ensure the longevity of the fund.

In choosing a consultant, look for one who specializes in working with nonprofits and who understands the nuances of your organization. To find suitable candidates, ask other organizations similar to yours about their experiences.

Your Endowment Team

Creating and operating an endowment is a group effort. You'll likely need the involvement of the following players.

- **Your Board**
  Participation by all board members in the development of the endowment will be key to its success. They should help explain to the community why the endowment is important to your nonprofit, open doors for potential donors and more. The fundraising committee and investment or endowment committee, in particular, should be heavily involved throughout the process.

- **Key Staff**
  Leadership of the nonprofit, including your executive director, chief financial officer and development director will have vital roles in the development and operation of the endowment.

- **An Attorney**
  You will need to engage counsel experienced in working with nonprofits.

- **An Accountant**
  You'll also need the assistance of internal and likely external accounting experts.

- **A Financial Advisor**
  You'll need banking services and an investment consultant to manage endowment assets.

The Regions **Philanthropic Solutions** group work is solely with nonprofits. We have experience working with organizations of every size and type, and we can also refer you to accounting and legal firms that have experience helping nonprofits.

Regions has deep experience structuring and managing endowment investments. The investment team will sit on your side of the table, working with you to understand your organization's goals and create a diversified portfolio that can provide current investment proceeds while growing to fund future needs.

If you would like additional guidance for starting an endowment for your organization, contact us or visit **regions.com/investmentleadership.** ▲

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