# NONPROFIT ENDOWMENT FUNDS –
## WHY AND HOW LGBT MOVEMENT ORGANIZATIONS SHOULD ESTABLISH THEM

February 2009

MAP
movement advancement project

## Overview

As the news media deliver daily stories of record stock market lows, new layoffs and dwindling consumer confidence, nonprofits of all stripes are bracing for cut backs in donations from individuals, foundations and corporations. At the same time, millions of retiring baby boomers are planning their estates, leading eventually to a massive transfer of wealth to their heirs and favorite charities. Given these conditions, LGBT nonprofits need to strengthen their development efforts to meet today's unprecedented fundraising challenges and opportunities. Expanding efforts to build endowment funds and pursue planned giving will not only help LGBT organizations find new donors, but also build cash reserves to help weather future financial storms.

This primer provides a snapshot of current endowment funds and planned giving programs at LGBT nonprofit organizations. Overall, we find that most organizations have little in the way of permanent or board-created endowments, and few are engaged in active planned giving development.

Based on our findings and research, we recommend that LGBT organizations:

1. **Review and assess existing nonprofit resources on endowment building and planned giving.** While researching this issue brief, we found a wide range of resources for organizations interested in establishing endowment funds or planned giving programs. Although we did not have the time to fully vet this information, our initial sense is that they can be adapted for the movement's use without investing too much time or money.

2. **Create a directory of LGBT-friendly community foundations that also manage endowment funds.** Many community/public foundations manage endowment funds for local, regional and national organizations. Although these foundations charge fees for managing these funds, they also significantly reduce the amount of organizational staff time and skill that endowments usually demand.

3. **Convene LGBT development staff.** We think there is value in convening development staff from LGBT organizations to discuss endowment building and planned giving programs, as well as other development challenges and opportunities that the LGBT movement currently faces.

## Introduction

The term "endowment" means different things to different people in the nonprofit sector. Accountants and government regulators have strict definitions of what an endowment is, based on the legal restrictions imposed on a gift by the donor, while nonprofit staff and board members might refer to a wide range of financial assets as endowments. The media and charity watchdogs could have their own definitions of the term, creating confusion in donors' minds as they attempt to evaluate an organization before making a financial gift.

Most of the nation's leading LGBT nonprofit organizations appear to have little experience in managing endowment funds, regardless of the definition used. MAP's review of 52 major organizations shows that just 10 have permanent endowments in place, while another seven have established quasi-endowments held as long-term investments.[1] Bequests, which could form the seed for an organization's endowment fund, remain a small portion of most organizations' annual revenues. Further, given few donor-set restrictions on bequests, organizations are likely to use these gifts to support current operating expenses.

In the LGBT movement's relatively short history, its organizations have faced many pressing, short-term demands (e.g., the HIV/AIDS crisis, ballot initiative campaigns). These circumstances, at least in part, explain why most movement organizations have not yet established financial reserves or planned giving programs; their focus has largely been on raising and spending money quickly in the short-term.

With this primer, MAP aims to help LGBT movement organizations and donors understand nonprofit endowment funds, and the challenges and opportunities they create. We begin by defining and explaining key concepts, which we think will enable a more efficient conversation about endowment funds in the movement. Second, we provide information on the endowment funds at leading LGBT groups, as well as a snapshot of their current efforts to recruit donors to planned giving programs. Third, we discuss the pros and cons of having an endowment fund, and best-practice recommendations for groups considering establishing their own endowment funds. Finally, we wrap up with suggestions for next steps in the LGBT movement's emerging conversation about building its future wealth and long-term capacity.

## Key Terms

An **endowment fund** is comprised of three types of endowments that are maintained and tracked separately:

- **Permanent Endowment.** A gift that a donor makes to an organization, with the stipulation that the principal be invested in perpetuity and never used for any other purpose (unless the original donor changes his or her mind, or a court decides that the recipient organization can liquidate the original gift). Typically, the investment proceeds (interest and dividend income, and realized/unrealized gains) are

[1] We looked at the finances of the 52 national, state and local organizations that participate in MAP's Standard Annual Reporting project.

considered unrestricted and can be used to support the organization's general operations.[2]

- **Term Endowment.** A gift that a donor makes to an organization, with the stipulation that the principal be invested and never used for any other purpose for a specified term. This type of endowment is considered temporarily restricted. But because in practice this type of endowment is rarely used, it will not be discussed in the rest of this primer.

- **Quasi-endowment.** An organization's board of directors may establish its own endowment, usually in an effort to build a reserve fund for future needs (these endowments are sometimes referred to as **"rainy-day funds"**). These **board-designated reserves** are not legally restricted by a donor so they must be kept separate from the permanent endowment. A board can usually, through a simple majority vote, decide to liquidate some or all of these assets and use them for operations or to support a specific project or need.

Organizations often establish quasi-endowments when they receive a **bequest**, which is a gift to an organization from a deceased individual's estate. These gifts can be **restricted** by specific donor instructions for their use (for example, to endow a scholarship program for disadvantaged youth) or they can be given without any strings attached (i.e., they are **unrestricted**). Organizations often are unaware that they have been designated the beneficiary of a bequest until the funds arrive, allowing them to more easily set aside this windfall as a quasi-endowment (assuming the donor has not made any stipulations for its use).

Bequests are just one type of **planned gifts**. Generally speaking, planned gifts include a variety of financial instruments that a donor can use to either give money or other assets to an organization at the time of his or her death, or during his or her life while still receiving financial benefits from the gift. Bequests are an example of the type of gift made at the time of death, while charitable remainder trusts are a type of gift made during a donor's life.[3]

Beyond bequests, boards can establish a quasi-endowment by voting to allocate any surplus cash to such a fund. Another option is to fundraise specifically for a quasi-endowment, or to decide to place a certain percentage of each dollar raised from individual contributions into the quasi-endowment.

## Current Bequests and Endowments in LGBT Nonprofits

In 2007, the 52 organizations that participated in MAP's 2008 Standard Annual Reporting (SAR) project had total combined revenue of $225.8 million. Bequests made up just 3% of this revenue, $7.7 million. This represents an increase over 2005 and 2006, when bequests made up just 1% and 2%, respectively, of those years' revenues. In 2007, only 15 of the 52 organizations (29%) reported bequest income, compared to 12 (23%) and 14 (27%) organizations in 2005 and 2006, respectively. Eleven organizations reported receiving bequest revenue in each of the three years analyzed.

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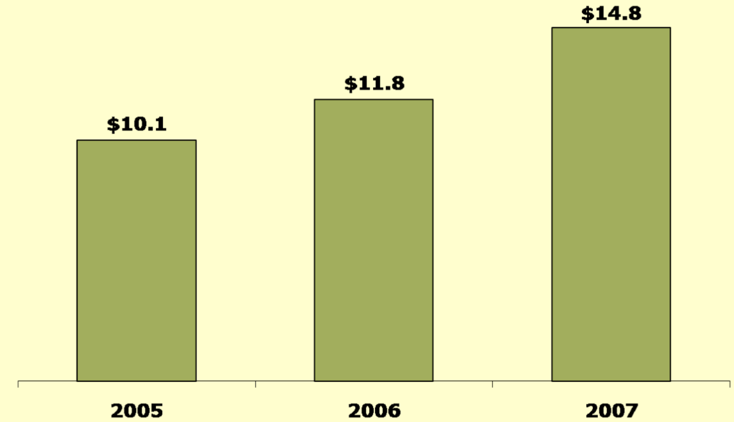
[2] Any realized/unrealized losses incurred would also be recorded as part of the organization's unrestricted operating results.

[3] Readers should note that there are several types of planned gifts, each with its own legal and accounting requirements. Defining and explaining these different giving vehicles – and their legal implications – is beyond the scope of this primer.

Even fewer organizations reported having permanent endowments. In 2005, 2006 and 2007 only 10 groups reported having permanent endowments. As ***Figure 1*** shows, in 2005 combined permanent endowments totaled $10.1 million, increasing to $14.8 million in 2007. In 2007, the smallest permanent endowment was just under $10,000 while the largest was nearly $9 million. This $9 million in one organization accounted for 60% of all permanent endowment funds. Furthermore, combined permanent endowments equaled barely 7% of the organizations' combined revenues.

**Figure 1: Permanent endowments across 52 LGBT organizations**
Millions of dollars



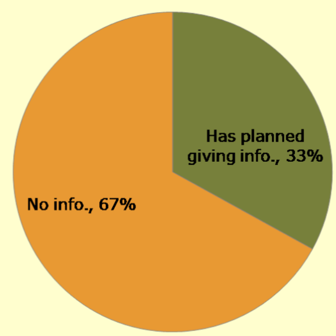

Source: MAP, *2008 Standard Annual Reporting* project.

In 2007, only seven organizations had quasi-endowments (i.e., board-designated reserves), ranging in size from $140,000 to $2.5 million.[4] Combined, they totaled $7.5 million. Although most of these groups did not explain what the funds would be used for, a few mentioned that they are to be used for specific programs or scholarship funds.

Although organizations often do not know ahead of time that a donor has left them a bequest in his or her will, these gifts can be the end result of careful, long-term planning between the donor and recipient organization. As mentioned earlier, bequests are just one of several planned giving vehicles that organizations can use to tap into donor wealth. Overall, it seems that most LGBT groups do not have active planned giving programs. Looking at the 52 SAR organizations, only 17 groups (33%) had information about planned giving on their websites (see ***Figure 2***).

[4] This analysis is based on MAP's review of audited financial statements and other information that groups submitted during the 2008 SAR project. Since we did not specifically ask about these types of funds in the 2008 SAR, it is possible other organizations have them but didn't flag them in the information they provided.

**Figure 2: Percentage of LGBT organizations with planned giving information on their websites**




Source: MAP's review of 52 SAR organizations' websites, January 2009.

It was beyond the scope of this research to survey the 17 organizations to ask if their development staff were actively seeking planned gifts, as opposed to merely posting information about planned giving on their website. Our guess is that far fewer than 17 organizations are doing active outreach to solicit planned gifts. With many baby boomers nearing retirement and actively planning their estates and so few LGBT groups having active planned giving programs, the LGBT movement could be missing out on an unprecedented opportunity to secure large planned gifts.[5]

## Endowment Funds in Practice

### *Endowment pros and cons*

There are three main reasons why an organization would want to establish and build an endowment fund:

- **Source of unrestricted income.** Prudently invested, endowment principal can generate investment income that can be used to maintain the organization. In most cases, net investment income generated from permanent endowments is unrestricted in its use by organizations.

- **Stability and permanency.** An endowment fund signals to donors and the community at large that the organization plans to operate for the long-haul. This can help to convince donors (both individual and institutional) that they're making a good investment by supporting a stable organization.

- **New donor market.** Some donors have a strong desire to leave a legacy through their philanthropy. Without an endowment fund in place, it's difficult for an organization to target these donors or secure a substantial gift from them. Establishing an endowment opens an organization to this new donor market, the

[5] For example, the Horizons Foundation recently researched individual LGBT philanthropy in the Bay Area of California. One of the research's most compelling conclusions is that "It is [critical] for the LGBT movement and community to move decisively to make the most of the window of opportunity now open in planned giving." See Horizon Foundation, *Building a New Tradition of LGBT Philanthropy*, 2008.

members of which are typically wealthier than other individual donors. If the gift is substantial, an organization can establish a specific permanent endowment in the donor's name.

But building up asset reserves has several downsides, as well:

- **Current vs. future needs.** Raising money for an endowment usually means less time to raise money for current operations and programs. This concern is especially relevant if an organization provides direct services to people in need. Two organizations that we spoke with for this primer believe that solving problems today takes a higher priority over future work. Consequently, they deliberately do not pursue endowment funds. One of these groups said that it would not necessarily turn down a donor who wanted to establish an endowment at their organization, but still stressed that their focus is on raising money to support work that will help solve today's problems.

- **Giving deterrent.** Some donors will not support an organization that has money in the bank that is not being used to meet today's needs. In fact, the American Institute of Philanthropy and the Better Business Bureau's Wise Giving Alliance consider an organization's reserves when they evaluate and grade groups. Both watchdogs reduce ratings for organizations that have more than three years of current operating costs in unrestricted cash.[6] The good news is that they do not take into account permanent endowment money that is restricted by the donor. But they will include quasi-endowments in their grading process.

- **Endowments aren't free.** Raising and managing an endowment require staff to have specialized skills. For example, raising money for an endowment requires a different approach from that needed to raise money for a current project from a wide range of $25 or $50 givers. If current development staff members lack the needed skills, investments will need to be made in training staff or hiring new personnel. Similarly, finance staff members need to know how to best invest endowment monies and accurately account for and report them in financial statements and annual filings to the Internal Revenue Service.

Despite the downsides, it makes sense for an organization to have an endowment fund, even if it is just a simple "rainy day" reserve (i.e., a quasi-endowment) that would cover basic operating costs for six months or a year. But before seriously beginning to build an organization's endowment fund, its leaders need to be fully aware of the challenges involved. In particular, given the tradeoffs briefly outlined above, an organization needs to engage in a strategic, thoughtful conversation before establishing an endowment fund. Ideally, this process would involve the board of directors; key senior staff, including the development and finance directors; and (perhaps) some of the largest or most loyal donors.

[6] Based on data that MAP collected for the 2008 SAR, LGBT organizations do not come remotely close to crossing this threshold. The average organization in 2007 only had 149 days of working capital available. The highest number of days of working capital available was 597 (three years equals 1,095 days). Days of working capital show how long an organization can continue functioning at its current level of operations, without an additional infusion of cash.

***Organization capacity to acquire and manage endowments***

Assessing an organization's capacity to establish and manage an endowment fund is a critical first step. Some questions to consider include:

- Does the board or staff have the development skills needed to raise money for an endowment fund, which will likely involve targeting high-wealth individuals and navigating the complicated world of planned giving?

- Similarly, is the finance staff trained in managing, investing and reporting on nonprofit investments?

- Do board and staff members know how to "market" the endowment fund to the donors who might be dissuaded from supporting the organization because it has "money in the bank"?

- If the development and/or finance staff is lacking in the needed skills, can the organization afford to train them or hire new personnel?

Organizations that lack the staff needed to manage an endowment can place the funds in a community or other public foundation. In most cases, these institutions will invest the principal, pay out any scheduled grants or proceeds and help with public reporting requirements. This support is not free, however, with most foundations charging a percentage of the total investment as a management fee. The Arkansas Community Foundation, for example, charges ½% of a fund's balance, with a minimum annual fee of $50. However, most of these foundations will only manage permanent endowments; they will not manage or invest quasi-endowments or other money that is not permanently restricted by a donor.

***Quasi-endowment considerations***

If an organization decides to establish and manage a quasi-endowment, here are some practical issues for board and staff leaders to consider:

- **Funding the quasi-endowment.** Everyone should agree where the money for the quasi-endowment will come from. Options include:

  - Adopting a new policy that requires surplus cash to be rolled into the quasi-endowment.
  - Allocating a certain percentage of all individual contributions to the quasi-endowment.
  - Actively seeking unrestricted bequests for the quasi-endowment.

  Being clear about how to build a quasi-endowment will help board and staff members clarify their fundraising responsibilities, and also prepare development staff to market the endowment to both existing donors and potential new supporters.

- **Investing quasi-endowment funds.** The organization needs to decide the type of investment vehicle to be used to maintain and grow the quasi-endowment. This decision depends on a number of factors. For example:

- How much risk is the organization willing to assume with the investment? Is it looking for a potentially high payoff in exchange for higher-risk investments, or lower returns in exchange for low or next-to-no risk?
- How liquid does it want the quasi-endowment principal to be? Answering this question will depend on the organization's overall financial health. In particular, will it need to use the quasi-endowment for any near-term operating costs? In some cases, the organization might end up paying a large penalty if it withdraws the funds earlier than planned.

- **Using the quasi-endowment funds.** The board of directors needs to agree how and when the quasi-endowment can be tapped. For example:

  - Will it require a simple majority vote to liquidate the funds?
  - Does the vote need to happen during an official board meeting, or can it be conducted at any time?
  - Do a minimum number of board members need to be present for the vote to take place?
  - Will there be any restrictions placed on the money? For example, can it be used to pay for capital costs or unexpected legal fees, or is it only for program-specific needs?

  Establishing written policies for using quasi-endowments can help the board navigate contentious discussions in the future, especially during a time of crisis.

Overall, an organization should approach the quasi-endowment game with some caution. Quasi-endowments can help build an organization's stability and capacity over the long-term, but to work well it needs to be carefully thought about and discussed early on. We encourage organizations to rely on trained professionals to help facilitate and guide their planning.

## Next Steps

Based on our assessment of the current state of endowment building and planned giving in the LGBT movement and the broader nonprofit sector, MAP recommends the following next steps for LGBT organizations:

- **Closely review and assess existing nonprofit resources.** While researching this primer, MAP found a wide range of resources for organizations interested in establishing endowment or planned giving programs. Although we did not have the time to fully vet this information, our initial sense is that they can be adapted for the movement's use without investing too much time or money (in other words, we're not starting from scratch; we should take advantage of the fact that others have already wrestled with endowment and planned giving challenges).

  In particular, the Partnership for Planned Giving (formerly the National Committee on Planned Giving) can be a good resource for training LGBT movement development staff in how to establish and manage planned giving programs.[7] The Partnership's *Leave a Legacy* project could be of particular interest, as it works to educate donors (both large and small) on how to leave bequests to nonprofit organizations.[8]

[7] See www.ncpg.org.
[8] See www.leavealegacy.org.

Similarly, the Virginia G. Piper Charitable Trust's *Arizona Endowment Building Initiative* might be a useful model for the LGBT movement to follow. This program trains nonprofit development staff to learn and adopt new methods of building endowments for their organizations.[9]

- **Create a directory of LGBT-friendly community foundations that also manage permanent endowments.** As stated earlier, many community/public foundations manage permanent endowments for local, regional and national organizations. Although these foundations charge fees for managing permanent endowment funds, they also significantly reduce the amount of organizational staff time and skills that permanent endowments require.

- **Convene LGBT development staff.** We think there would be value in convening development staff from LGBT organizations to discuss endowment building and planned giving programs. Organizations already engaged in these efforts could share best practices and other advice, or outside development experts could be brought in to facilitate discussions and trainings. We think this networking is especially important at the onset of this type of development work, as staff learn the basics and look to their peers for support. Even informal (and inexpensive) conference calls would be a good first step for these meetings.

  Apart from helping groups become more adept at planned giving and working with endowments, a meeting of this type could also serve as a general professional development opportunity for the movement's development staff. We are not aware of any already-existing opportunities of this kind. This meeting could be especially timely as organizations confront a wide range of serious fundraising problems related to the economic downturn.

Of course, the above recommendations cannot be implemented for free. LGBT foundations should consider supporting the work outlined above, understanding that their investments in planned giving and endowment building could lead to large payoffs in the long run.

### ***Conclusion***

The LGBT movement and its advocacy and service organizations are relatively young, with most groups operating informally or with very few resources for most of the past 30 years. In their short history, they have faced a serious health crisis (HIV/AIDS) and numerous ballot initiatives. Both forced LGBT groups to raise and spend large amounts of money quickly in short spans of time. Not surprisingly, the movement's organizations have not had much time to seriously consider building an endowment fund or planned giving programs.

But now that the movement has reached some level of stability and maturity, organizations should seriously consider increasing their planning for longevity. In at least one respect, the timing for this work could not be better. Philanthropy experts expect millions of retiring and aging baby boomers to transfer billions of dollars to their heirs and favorite nonprofit organizations in the coming years. Although the recent stock market declines will reduce how much people are able to give, substantial resources will still be changing hands. If the LGBT movement wants to take advantage of this coming transfer of wealth, its organizations need to start planning now.

[9] See www.azebi.org.