Accepting and Managing Restricted Gifts in Challenging Times

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Agenda

- In challenging economic times, it's important to consider—
  - How you can use the funds you have
  - What changes you can make to how you use the funds you have
  - Best practices for gift acceptance
    - To ensure alignment with donor intent
    - To maximize flexibility for your organization
- This involves assessment of (among other things)—
  - Reserves and endowment funds
  - Spending policies
  - Purpose-restricted funds
  - Naming policies and practices
  - Gift acceptance
- Both legal and practical considerations

Uniform Prudent Management of Institutional Funds Act (UPMIFA)

- **Sets standards for managing and investing "institutional funds"** (i.e., funds held for exclusively charitable purposes)
  - Must give primary consideration to donor intent as expressed in a *gift instrument* (formal or informal)
  - Must act in good faith and with ordinary prudence
  - Portfolio view of investments
- **Provides guidance regarding the release or modification of donor-imposed restrictions on the management, investment, or purpose of institutional funds**
- **Provides guidance for spending from endowment funds**
  - What's prudent for uses, benefits, purposes and duration for which the endowment fund was established

Uniform Prudent Management of Institutional Funds Act (UPMIFA)

In deciding how much is prudent to spend from an endowment, UPMIFA provides that you must consider, if relevant—

(1) the duration and preservation of the endowment fund;

(2) the purposes of the institution and the endowment fund;

(3) general economic conditions;

(4) the possible effect of inflation or deflation;

(5) the expected total return from income and the appreciation of investments;

(6) other resources of the institution; and

(7) the investment policy of the institution.

How useful is an endowment in a crisis?

- UPMIFA: An endowment is an institutional fund that under the terms of a gift instrument is <u>not wholly expendable by the institution on a current basis</u>
  - Endowment restriction must be placed by the <u>donor</u>
  - Language to use only the "income," or "interest," or "to preserve the principal intact" create an endowment subject to UPMIFA's default rules
- Often, an endowment is a <u>public relations challenge</u>
  - *"Why aren't you using this resource"*
  - *"Why are you wasting this resource"*
  - *"Why do you need anything more if you have this resource"*
- An endowment is **NOT**—
  - A fund without timeline spending restrictions
  - A fund with Board-designated timeline spending restrictions
  - A "rainy day" fund

Endowment Questions in Challenging Times

- **Really, how much can we spend from our endowment?**
  - Not a bright line maximum or minimum
  - Board discretion and decision-making protected by business judgment rule
  - UPMIFA’s prudence standard likely allows temporary increases in spending
  - Preservation of spending power (not historic dollar value)
  - *What does your spending policy say? When was it last reviewed?*
- **Can we raise money by assessing an administrative fee on endowment funds?**
  - UPMIFA allows incurring reasonable costs in managing and investing funds
  - Typically in the 1% to 2% range
  - How are funds from the fee used?
    - Pay investment management costs—donors likely to understand
    - Pay fundraising or operating costs?—donors less likely to understand
  - *Have you fully disclosed to your donors?*
    - In the gift instrument?
    - In your endowment investment policies?

Endowment Questions in Challenging Times

- **Can we borrow from our endowment to put money to work now?**
  - UPMIFA does not address this
  - A “loan” to the nonprofit itself likely should be viewed as a distribution from the endowment, subject to the same considerations that apply to other distributions—i.e., the notion of borrowing from an endowment does not necessarily provide an organization greater spending leeway
  - Still subject to UPMIFA’s prudent spending analysis
- **Can we use our endowment funds as collateral for a loan?**
  - UPMIFA does not address this, either.
  - Even if permitted, it would be very risky to pledge the principal of an endowment as collateral
  - Generally, a nonprofit can only pledge property that the nonprofit has the right to access on a current basis
  - Some large foundations are issuing taxable, corporate bonds to put more funds to work on a current basis—these are ***not*** secured by endowment assets

Purpose Restrictions

- Gifts also must be used for the specific purposes directed by the donor(s)
  - If UPMIFA applies, the restriction is only binding if in a written “gift instrument.”
    - Board-restricted funds are not restricted
  - For express trusts, the language of the trust instrument and donor intent control
    - The trust code governs interpretation and provides default rules
- Requirement to use charitable gifts for intended purposes is enforced by the Attorney General
- Generally, in MN, donors do not have standing to enforce a charitable gift
  - Exception for reversionary interests

Other Restrictions on Gifts

- Scholarships
  - Non-discrimination considerations – Title VI, Title IX
  - DAF restrictions
- Use of gifted property
  - Limitations on sale timing or terms
  - Use in particular missions

Naming Rights

- Naming rights should be granted carefully
  - Can be a great fundraising tool
  - Can inhibit future fundraising
  - Can damage image
  - Can create impression of donor control

- Consider naming rights policy
  - Time limit
  - Morality and change-of-circumstances clauses
  - Future donors with co-naming rights or adjacent rights
  - Dollar minimum

Compliance with and Modification of Restrictions - UPMIFA

- Options for modifying a restriction in an UPMIFA gift instrument (or not):
  - Make it fit
  - Variance power/change-of-circumstances provision?
  - Donor consent in a record
  - Court action (*cy pres* doctrine)
    - Incorporates trust standard (Minn. Stat. § 501B.31): If "circumstances have so changed… as to render impracticable, inexpedient, or impossible a literal compliance with the terms of the instrument," the court may modify the fund "in a manner the court determines will, as nearly as possible, accomplish the general purposes of the instrument and the object and intention of the donor."
  - Old, small funds submission to Attorney General and no objection in 60 days
    - Over 20 years and under $50,000 (in MN; it's 10 years in MO)

Compliance with and Modification of Restrictions – Express Trusts

- Express trusts under 501C
  - A trustee or a beneficiary may bring an action to modify or terminate a charitable trust
    - Same standard as for court modification under MN's UPMIFA (discussed above)
  - Donor's intent is the primary touchstone in modifying a trust.
  - In Minnesota, a settlor is not granted standing to appear as a party in a court proceeding for enforcement or modification of an express trust
  - Nonjudicial settlements: All interested persons must agree
    - AG is a qualified beneficiary for charitable trusts and may not agree to participate
    - Often the cost of an NJSA is commensurate with the cost of simply going to court

Examples of Restricted Gift Issues

- Closing or selling a location
- Changing programming, curriculum
- Inability to expend the funds on the stated purpose due to reduction in need or qualification
- Morality concerns
- Restructuring
- Bankruptcy/creditors

Best practices for accepting restricted gifts

- Adopt and follow a gift acceptance policy
- Do not undertake programs not already within the organization’s charitable mission or goals
- Fully investigate the proposed terms and nature of the gift
- Give the organization as much discretion as possible regarding the operation of the program and the selection of a new purpose if necessary
- Resist donor control
  – Preserves donor’s tax deduction
  – Prevents disagreements (e.g., resist giving donors the right to direct charity’s activities)
  – Maintains operational flexibility
  – Include standards and limitations in your gift acceptance policies

Specific terms to include in gift instruments and trusts

- Define the purpose broadly enough to allow programs, amounts, restrictions to be changed within the purpose
  - Individuals and officers within institution who will administer the gift should confirm the feasibility
- Clear terms about pledge payment schedules, or triggers
- Clear and limited terms about recognition, see below
- Include change of circumstances clause to be determined in the trustee's or nonprofits discretion:
    - *If [nonprofit] determines, in its sole discretion, that due to a change in circumstances, compliance with a restriction contained in this gift instrument is impracticable, inexpedient, impossible, or not in [nonprofit's] best interest, [nonprofit] may modify the restriction to accomplish, as nearly as possible, the general purposes of this gift instrument and the object and intention of the Donor, without regard to the specific restriction*
    - Best interests standard recommended to allow changes for reputational concerns, etc.
  - Backup plan: a stated alternative use
  - CRTs and CLTs can give the trustee power to choose an alternate charity but care must be taken not to disqualify

Specific terms to include in gift instruments and trusts (continued)

- Expressly state:
  - – Gift is irrevocable, unconditional, and not a trust (for an UPMIFA fund) or a contract
    - Avoid using contract provisions, e.g., agreement, representations, boilerplate
  - – Donor retains no rights with respect to the gift
  - – State body of applicable law: UPMIFA or trust law
  - - Gift instrument supersedes all other communications and embodies all the terms
  - – Costs of investing and managing the fund or trust may be paid from the trust

THANK YOU!