CHAPTER 1

Understanding Endowment

ENDOWMENT FUND RAISING differs from other fund raising in fundamental ways and offers distinct advantages to nonprofit organizations. But endowment fund raising should not to be entered into lightly. In this chapter, you will become familiar with the basic language of endowment fund raising and learn about the structural models that can be used to organize an endowment fund raising program. These tools are the basis of the education you and your organization's board and staff will need in order to make critical decisions about endowment fund raising.

DEFINITIONS

Endowment: A fund of money, the principal of which is held in perpetuity and invested and from which an organization may use only the return on investment.

Endowment fund: The formal term to describe the accounting placement of endowment monies in the income statement of an organization.

Endowment campaign: A campaign to raise endowment that is managed and directed much like a capital campaign, with specific goals and a time-limited framework.

Endowment program: The permanent, continuous fund raising effort to build endowment. From time to time, the program may include an endowment campaign.

Endowment advisory committee: A group that explores key questions about an organization's mission, structure, and donor base and evaluates its readiness for endowment building.

Endowment steering committee: The group of volunteers, both board members and nonboard members, whom the advisory committee selects to be responsible for a particular endowment fund raising effort.

Constituency: The group of potential donors to whom the endowment fund raising program is directed or marketed.

Unique Characteristics of Endowment Fund Raising

The strategies used to cultivate and solicit endowment gifts are similar to those used for major and capital gifts. But to build a successful endowment program, you'll need to be mindful of what's special about endowment fund raising:

The total raised will consist of a few large gifts rather than many small gifts. For the interest from an endowment to make a financial impact, there must be a significant amount of money in the endowment fund. The Rosso model, which suggests that 20 percent of the gifts should provide 80 percent of the dollars, applies to an endowment fund.

Negotiating an endowment gift will take longer than any other kind of fund raising. Because a request for an endowment gift often involves negotiating a major or planned gift, the time you spend with prospective donors will be longer and more demanding than the time you spend soliciting an annual gift or even a capital gift.

Endowment donors are sophisticated about ways of giving. Most donors have already been approached by their church, their college or university, or their hospital about endowment giving and planned giving. They know the language and often understand the nature of the gifts long before we call on them.

Solicitations will require you to make more personal contact than you do during other types of fund raising. Endowment fund raising can't be done entirely by phone or mail. The personal approach is the most effective because of the types of gifts requested and the complex nature of endowment.

Prospects will ask tough questions. Prospects will want to know where the money is invested, who the investment counsel will be, and what return you are expecting; they'll ask for a wide range of financial and money management information that is almost never requested during other kinds of fund raising.

Prospects will want proof that the endowment gift is a good investment. Balanced budgets, sound financial management, and board oversight of funds are all-important components of the endowment story. Prospects may well base their decisions on this information. They are making an investment; they think like investors.

Prospects will want proof that their endowment gift will make a difference. It is vital that your organization have a clear vision of the impact that endowment will have on the quality and quantity of service provided to the community by a nonprofit organization.

Prospects will want to know the entire endowment plan. They'll probably want to know how big the endowment will be, how many donors you expect, and what the long-term goal is. Endowment donors think big and ask tough questions. Your organization must have the answers.

The Benefits of Endowment

Endowment income provides key benefits to a nonprofit organization; these are discussed next.

Financial Stability

The nonprofit funding environment is volatile and creates a sense of unease and inconsistency. Income from endowment can effectively smooth out the rough spots in a fiscal year. Endowment can be used to underwrite programs that have not been funded, support budgets when there are shortfalls, enable management to continue to move the institution forward, even in difficult financial times, and provide a safety net when an unexpected financial crisis occurs. In sum, endowment can help an organization realize its inspirational and visionary ideas.

Use of Risk Capital

In the planning process, new and innovative programs and services are often discounted because they can't be funded. With income from endowment, organizations can take some risks. Endowed institutions can fund new programs, start new initiatives, and reach out to provide more services. Although such risk capital sometimes comes from generous donors, sources of that type are neither reliable nor consistent.

Financial Control

Virtually every source of nonprofit income, from earned income to philanthropic income, has been difficult to forecast. There are good years and bad years. There are variables in the environment that the nonprofit cannot control; donors, grantors, and even clients do not or cannot always do what we would like them to do financially. Income from endowment, however, is in the control of the organization; unrestricted endowment, in particular, becomes a bedrock of security and power for the organization. These types of endowment are described later in the chapter.

Donor Incentive

The existence of an endowment fund is an incentive for donors to give to an organization, because an organization with an endowment is likely to be perceived as stable and financially mature.

Permanence and Longevity

A prospective donor must believe and see evidence that an investment in endowment will continue to make a difference beyond the donor's lifetime. The very existence of the endowment is an important piece of evidence. When a donor sees a strong endowment, he or she understands that the organization will continue to exist for a long time.

Ten Reasons Why People Give to Endowment

Donors like to give to endowments for many of the same reasons they give to any cause they care about. However, you will find in the list that follows some reasons that are distinctly different from reasons for giving to anything else:

1. They believe in the cause, and they were asked to give.
2. They believe in the cause and have a link to it.
3. They believe in the asker.
4. They like the idea of perpetuity, that is, giving beyond their own life.
5. They are dedicated to the specific project or program with the organization that the endowment will fund.
6. Their business or industry will gain from the gift.
7. They like the idea that their gift will grow with sound investment and spending practices.
8. They are impressed with the investment advice and proposed management of the endowment.
9. They would rather give to your organization than to the government. In other words, they want the tax advantage.
10. They have a history of giving to endowment and understand the benefits.

Endowment Types

Every organization has some special financial needs and responsibilities that can be secured through endowment. Colleges and universities will always want scholarship funds for worthy students; hospitals will always want to underwrite the financial cost of care for those who cannot afford care, and other nonprofits will always want to underwrite specific institutional needs. And to help fill some of those needs, here are some of the many types of endowment to choose from:

Term endowment: A fund of money given by a donor to be used for a term agreed to by the nonprofit and the donor. For example, the donor may want the return on investment to be used for building maintenance and upkeep for a period of ten years, at which time the organization may use the principal as it sees fit.

Quasi-endowment: A fund from which the organization may take either the annual return or some portion of the principal for use as needed.

Unrestricted endowment: A gift that allows the institution the flexibility to use the return on investment as best serves the immediate needs of the institution.

Restricted Endowments

Another type of endowment is restricted gifts, which are somewhat more complicated in that the donor can choose to endow a specific program or a particular staff or faculty position; or the gift may fund an organization's recurring need. Restricted endowment gifts are attractive to many donors and can stabilize an organization. For example, if a donor endows the office of the symphony director and all attendant costs, any part of the symphony's operating budget that had originally been allocated to those costs is now available to be used as needed.

Here are some possibilities for restricted endowments:

Program endowment: A gift to a particular program within an organization that helps secure its future. For example, a health care institution may wish to endow the building and operating costs of a hospice, or a boys' and girls' club may wish to endow a basketball program.

Named memorial endowment: An endowment fund named for an individual being honored by the donor. For example, the Ralph Williams Endowed Fund may have been named by the children of Ralph Williams to honor his long affiliation with a school's athletic program.

Scholarship endowment: A fund that endows scholarships. Educational institutions have found that many donors wish to underwrite scholarship funds in perpetuity. Or a ballet company with a school or a social service agency that provides an educational component may find a scholarship endowment to be very helpful.

Uncompensated care endowment: A fund that allows donors to underwrite those who are least able to use the services of an organization. Such a fund could be particularly useful to children's hospitals, which often provide a great deal of uncompensated care.

Endowment for a faculty or staff chair: A fund that underwrites the cost of academic faculty through endowed chairs.

Facilities endowment: A gift to underwrite operating expenses. Fund raising for the day-to-day costs of heat, light, water, and power is exceedingly difficult. An endowment gift to underwrite these costs often comes from donors during a capital campaign.

Buildings and grounds endowment: A gift to underwrite the maintenance of property. Buildings and grounds always pose high financial risks to nonprofits. The ability to underwrite the cost of maintenance, repairs, and renovations through endowment stabilizes operational budgets.

Staff scholarship endowment: A gift to support education. For example, hospitals have had a great deal of success with building endowments to underwrite the cost of continuous and permanent nursing education.

Technology upgrade endowment: A gift to support improvements in technology. Technology changes so rapidly that no sooner does an organization update its technology than the technology becomes obsolete. For this reason, an endowment dedicated to helping an organization update and upgrade its technology continuously can be a most valuable gift.

Client services endowment: A gift to fund a service. A homeless shelter calculated that it would take $12,000 a year to operate one of its units for a family of four. The shelter set out to find six $10,000-endowment donors who, by combining their monies, would ensure that the shelter space was always available to a family. Donors loved the idea and found the size of the gift within reason. The joint venture worked quite successfully.

Integrating Endowment into Your Fund Raising Program

To be successful, an endowment program must be part of your organization's comprehensive fund raising plan. It is essential that fund raising for endowment be fed by the efforts of annual funds and the major gifts program. Successful endowment fund raising efforts are those that boast an ongoing, year-round process of cultivation, solicitation, and recognition; a permanent staff member usually oversees a successful endowment program. The staff person must make endowment fund raising a priority within the organization while educating the community about the importance of endowment.

It is easy to include an endowment fund when planning your general fund raising program. You might integrate endowment into your planned giving program by either establishing an endowment fund and soliciting planned gifts specifically for this fund or by creating named endowment funds as part of the planned giving process. You may choose to solicit endowment gifts the way you would annual gifts—asking for current cash or cash-equivalent gifts through face-to-face meetings or special mailings and directing the funds into the endowment. Many organizations choose to include an endowment fund raising element in a capital campaign, thus raising money to build a facility and funds to ensure its long-term use and maintenance at the same time.

Endowment Structures and Planned Giving

It is crucial that the organization and its donors understand that planned giving is not endowment any more than endowment is planned giving. The former is a type of fund, and the latter is a fund raising vehicle. Planned giving actually encompasses several giving vehicles, such as charitable remainder trusts, life insurance, and wills. The money from these planned gifts is often used to create and fund endowments. Donors may give cash, securities, property, and other tangible items that have a dollar value to an endowment fund. Planned giving is often considered the most efficient and effective way to raise money for endowment.

Organization-Owned Endowment

A nonprofit organization may choose to integrate an endowment fund and fund raising program into its current organizational structure. In this case, endowment staff is part of the fund raising staff. The day-to-day management of endowment is done in the financial offices of the organization, and day-to-day endowment fund raising looks and acts like simply an additional kind of organizational fund raising. The benefits of this model are efficiency and clarity of roles and responsibilities. For prospective and established donors, this model has the benefit of raising no questions about who is in charge of what.

However, care must be taken that the establishment of this endowment structure is not simply a formality. If the seams show, if the organization is on overload, if staff have no room left for an additional task, if endowment fund raising is just another item on the to-do list of already burdened board members, then this model will not work.

Separate Foundation

Some organizations choose to establish a separate and independent 501(c)3 organization to secure, manage, and distribute endowment. This organization is sometimes called a foundation, although it does not meet the true definition of a foundation, which is tied to the organization through bylaws, articles of incorporation, and the practice of linked boards. The foundation has a separate board with its own bylaws, articles, and operating practices, but board members often come in part or entirely from the founding organization. Key components of this organizational relationship include staffing, investing, allocating annual returns, using the organizational logo and name, and marketing.

There are good reasons for the establishment of a separate endowment-holding foundation. In some organizations, the board members have no responsibility for private sector fund raising and, frankly, no interest in it. Furthermore, in some organizations the day-to-day demands of operations and fund raising are so overwhelming that the addition of yet another function, without a separate supporting entity, would be impractical and could bring the whole system crashing down. Under these circumstances, if an endowment is to be created, a separate entity to raise and manage funds must be created as well.

Finally, an endowment foundation might be established because it enables the organization to identify, select, and recruit power brokers in the community. In terms of status, there is no comparison between being on an endowment committee and sitting on a foundation board. It may well be determined that the only way to get the "right" people involved is to have a structure that seems to offer them the status and stature they require.

The two models discussed next—Community Foundations and umbrella funds—are particularly appropriate for small nonprofits just starting to build endowments.

Community Foundations

If a nonprofit does not wish to form its own foundation, it may choose to associate with a Community Foundation. Community Foundations are established under a special set of federal laws that provide for only one organization of a particular type in a given community. Thus an organization has the privilege of being the only one of its kind in a given community.

Today, most Community Foundations across the country have both the capacity and the willingness to manage endowment funds for nonprofit organizations. The Community Foundation has the capacity to combine the endowment funds of many nonprofits, thus getting a big return at a low cost. Community Foundations are attractive to donors because they often have a long track record of investment success.

However, you may encounter resistance to the idea of turning over fund investment management to a Community Foundation. Often the funds become the property of the Community Foundation, and the principal will be returned only under a set of agreed-to circumstances. Boards in particular have some difficulty with giving up control of the endowment principal. Although it is true that the funds are in the control of the Community Foundation, the reality is that the funds were never flexible in the first place. They cannot be spent or used in any way. The credibility of the Community Foundation and its skills in investing are what the nonprofit is trading for perceived control.

National Umbrellas

Some national nonprofit organizations have set up umbrella organizations to hold endowments for local chapters or affiliates. If you are a member agency or affiliate, you will find your money in a large investment fund with the chances of both a better return and a lower cost than if you invested on your own.

What's Next?

Now that you are familiar with some of the basic concepts of endowment, you are ready to help your organization do an initial exploration of its commitment to and readiness for an endowment-building effort.