Building an Endowment: Is it Right for Your Organization?

Over the last few years, both donors and fundraisers have had the opportunity to consider the notion of endowments and how they might fit into an overall donor development model.

Over this time, I have discussed endowments with many people in the charitable sector. What I first realized was that "endowment" still remains a loosely described term whose formal definition is often a fleeting one. First, let us remember that "endowment" lacks a formal legal definition. Even the notion of "enduring property", which was traditionally viewed as synonymous with endowment, died with the changes to the Disbursement Quota rules introduced by the Federal Budget over a decade ago. As a general rule, it's probably easiest to see an endowment as an organization's savings account – the funds that the organization will not require to fulfill its immediate or short-term needs. This simplified notion isn't perfect but it's fairly easy to understand. For the purposes of this article, I will not expand on this definition.

I've also realized that there is a wide spectrum of opinion on where endowments fit into to an organization's development strategy. On one end, there are charities which will not incorporate endowments into their donor conversations. Perhaps their missions are defined by short-term goals or in some cases, they are profoundly worried that their existing stakeholders will view an endowment as a philosophical counterpoint to the organizational mission. On the other end is the organization that sees endowment building as an integral part of its development strategy. This may be reflected in a well-established planned giving program (it seems that a focus on planned giving and endowments have become synonymous in fund development, even though this doesn't necessarily have to be the case), staff training and a general focus on endowment building in all aspects of donor development.

Between these two highly diverse points of view sit the vast majority of charities. Whether a charity should or should not have a focus on endowment building is not the focal point of this article. Rather, this article will focus on the pragmatic aspects of endowment building – the "how to" of getting started. The vast majority of organizations with whom I have spoken share some common opinions on endowments.

1. They would like to have an endowment fund
2. If they have an endowment fund, they would like it to be larger
3. They are unsure what steps – both strategic and pragmatic – need to be taken to create or build an endowment
4. They are unsure how to focus on endowment building without cannibalizing existing development resources

Again, this article will not focus on whether endowments are good, bad, sustainable or necessary nor will it attempt to define "endowment" (legally or otherwise) in its current fundraising or institutional context. It assumes that the charity wishes to investigate the possibility of serious endowment building and is looking for opportunities to get started.

There are a number of fundamental steps that an organization must contemplate as it builds its endowment. For the purposes of this article, I have divided this process into four equally important stages. I would suggest that these four key areas will provide a starting point for any discussion around endowment building.

I – Strategic Focus: The decision to move forward on endowment building

II – Structure: Building the organizational structure around endowment building

III – Fundraising: Bringing in the funds that will grow the Endowment

IV – Investing: Investing and monitoring the endowment

Part I – Endowment as Strategy

Typically, the strategic direction for an organized is established through its governance structure and namely, its Board of Directors. The BOD, potentially through the advice and direction of senior staff and other advisors, will determine whether an endowment strategy is an appropriate one for the organization. Since endowments by their very nature require a long-term commitment, the BOD must understand that an endowment fund is part of an enduring vision for the organization. Furthermore, it is tough to get out of the endowment "business" once you've jumped in. Unwinding endowments can be a cumbersome and expensive process. Sometimes, it is virtually impossible to unwind an existing endowment.

Endowment building often stems from a strategic imperative to build long-term stability for the organization. It can also result from simply wanting to provide donors with a vehicle to leave a long-term legacy to the organization. Having said that, I would strongly suggest that those organizations which focus on endowments must take a highly proactive approach. Endowments don't build themselves and they typically don't build quickly. Patience and strategic nurturing lie at the core of any successful endowment program.

As with any strategic initiative, it is imperative that the BOD wholeheartedly support endowment building and, at the very least, understand its importance to the future of the organization. Clearly, the BOD will play an important role in shaping the direction of endowment building. In fact, the BOD's role lays the foundation for the next two sections – building the organizational infrastructure to support endowments, and creating a fundraising culture where endowment building is an inclusive part of an organization's broader attempts to fundraise.

Part II – The Infrastructure of Endowment Building

While having the support of the BOD is critical to the endowment-building process, it is equally important to build a sound administrative infrastructure. Proper governance of an organization's endowment is important. Proactively anticipating rather than reacting precipitously should be the governance mantra (probably not just of endowments but of governance in general!). Sometimes, these structural steps are not taken until the organization actually receives its first gift – I would suggest that they be taken much earlier.

The organization must put in place an appropriate structure to receive and administer endowed gifts.. Again, since the concept of endowment is a broad-based and loose one, the approach must account for flexibility and donor preferences. Will the organization accept only "permanent" endowments or will it contemplate the establishment of shorter term funds There are several fundamental questions which must be asked:

What type of gifts will be accepted (sometimes, this will result in the organization creating or revisiting its gift acceptance policy - never a bad idea)?

Will there be any board designation of planned/bequest gifts to the endowment (i.e. those that are not donor designated)?

What legal and regulatory requirements must be considered?

How will endowment donors be formally stewarded? How will endowed gifts be tracked?

Will the organization contemplate individually named funds? What will be the minimum donation?

What will be the endowment funds' broader disbursement/distribution policy (again, sometimes addressed in a separate policy)?

All of these questions – and more – are best addressed in the context of formal advice. The investment in professional support at this juncture is worth it.

Part III - The Funding of Endowments

Like all fundraising initiatives, endowments must be approached with a sound business mindset. The organization should evaluate whether endowment building is the best use of organizational resources. While I would suggest that endowment building requires more of a fundamental change in the organization's fundraising culture than a massive cost expenditure, it is undeniable that it will eat into the organization's human and financial resources.

So is it worth it? Again, this is beyond the scope of this article but I would suggest that there is an element of "go big or go home" when it comes to endowments   Small endowment funds (even if they are relatively large in the scope of the organization's overall financial position) can divert resources from more useful deployment of organizational capital. Large endowments, however, can truly provide an organization with a sense of long-term mission stability that can, at the same time, provide the organization with the foundation for continued program development or even expansion.

Endowment fundraising isn't easy. Many organizations have elected to fund their endowments through deferred gifts (e.g. bequests, insurance) of cash or property. In fact, this fundraising practice formed the foundation of many large Canadian endowments, most notably in the community foundation sector. Endowments, however, can be funded with more traditional and immediate gifts of cash, securities and other assets. Furthermore, the changes to the disbursement quota rules in 2010 (which among other things eliminated the most onerous long and short-term spending restrictions) have invariably changed our approach to endowments over time. In fact, the word itself may come to mean something new or it may in fact be replaced by a different moniker.

Some organizations dedicate specific people to endowment fundraising. Sometimes it the responsibility of the planned giving personnel ,and other times it is integrated into a broader major gifts philosophy, something which seems to make more sense to me. It has always seemed more logical to me for one person to act as a long-term relationship manager for a particular donor, allowing holistic conversations about broader philanthropy to take place to support the short and long term needs of the organization. However, there are many seasoned fundraisers who advocate both schools of thought. What I can promise is this: If fundraisers are not talking to donors about endowment building, it isn't going to magically happen.

There are many reasons why endowment fundraising hasn't achieved lofty heights, even for organizations which have strategically embraced the concept. It is because they have not established the fundraising culture, infrastructure and performance indicators that reflect this strategic focus. Given the choice, some donors will choose an endowment or endowment-like structure. Without that choice, the focus will always be on the organization's immediate needs – not necessarily a bad thing at all if this is indeed the intention of the organization.

Part IV - The Nuts and Bolts of Investments

Congratulations. You've received your first endowed gift – or perhaps your first in a very long time. Now comes the task of figuring out what to do with the money? Do you buy something secure like a Treasury Bill or a Cashable GIC or do you buy shares of a fast-rising gold stock. Neither, I would suggest, is an appropriate investment strategy for a charity.

There are many nuances when it comes to investment management and a "one size fits all" strategy simply doesn't apply here. There are regulatory and fiduciary considerations when it comes to investment management and the organization's BOD should be aware of them. Generally speaking, much of the regulatory basis for charitable investing stems from the provincial Trustee Acts. Again, the advice and support of experienced counsel can help establish the parameters. Perhaps you have already addressed these issues in anticipation of the first gift. Either way, a sound investment policy is the foundation of any good investment strategy.

So who makes the investment decisions? Sometimes, a separate investment committee is established reporting directly to the BOD. Sometimes, the BOD itself is directly involved in the process. Sometimes staff are involved in the process.

There are dozens of credible investment managers in Canada. So how do you choose one over the other? Furthermore, does the charity need to work through a financial advisor/planner/stock broker or should it work directly with an investment manager. Here are but a few of the questions that you should ask when evaluating potential managers:

- Does the IM have experience working with charitable clients including charities of a size and/or scope similar to yours?
- Does the IM understand the unique regulatory requirements of charities?
- What are the fees?
- What are the past performance figures (this one needs to be analyzed since IMs can slice and dice past performance figures – make sure you're comparing apples to apples)
- What other resources are at the IM's disposal that would help the charity?
- Does the IM have a strong focus on managing charitable endowments?
- Does the IM have the capacity to offer a socially responsible investment and/or impact investment option?

Considerable time and attention should be paid to the appointment of an investment manager and a charity may want to consider a more formal RFP (Request for Proposals) process. Furthermore, it is possible that the local community foundation may provide a suitable option, especially for charities who anticipate very moderate endowment holdings.

Endowments, when appropriately managed and resourced, can provide a charity with a sustainable source of funds. While some charities will not embrace endowments, I would suggest that this distaste is often rooted in a fear of an endowment's potential complexity. However, when approached properly, an endowment can bring stability, diversified funding and more options for donors.