CHARITABLE GIFTS: SPEND TO MAKE IMPACT

Before deciding to set up an endowment, donors should carefully consider the impact they wish to make, and over what period.

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Peter founded Northport Philanthropic Advisory Services to work with impact-orientated families and their trusted advisors to help them become highly effective donors, as measured by outcomes, impact, and personal fulfilment.

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Summary

Endowments are still a common tool used by donors to support charitable causes over the long term, but that may not be the best way to achieve philanthropic goals. If a donor's priority is to make greater impact sooner, they should consider creating an annuity or hybrid structure that aligns funding with need.

There are many societal and community problems and opportunities in the world to be addressed, some of which could be resolved with adequate and timely funding. Meanwhile, trillions of dollars have been stockpiled for charitable purposes that, if spent at a faster pace, could make a significant, if not transformative, difference.

Donors should be encouraged to start with considering what they would like to accomplish, and over what period. Only then can an informed choice be made about how to structure a charitable gift.

Introduction

Many people are philanthropic, supporting non-profit and charitable organizations that are focused on issues that align with their interests. Some individuals and families have wealth that allows them to give at extraordinary levels and make disproportionate impact in the areas they care most about.

Depending on their motivations and, often, the advice they get from professional advisors, fundraisers, and the organizations they are supporting, donors are sometimes presented with only two options: have their funds expended in the near term (e.g., helping pay for equipment or facilities that are needed now) or have their gift invested for the long term, with the income generated used to provide funding for a purpose (e.g., scholarships or bursaries) that would go on indefinitely.

The latter approach involves creating an endowment fund. As donors contribute to the fund, they enjoy tax benefits, and as the fund grows over time, a reliable and steady cash flow is available for spending on charitable purposes.

While endowments continue to be a common method of investing donated funds, especially following the introduction and growth of donor advised funds (DAFs)[i], they may not always be structured in a manner that best achieves the donor's true intent. That is because the default model for an endowment allows it to grow and generate income indefinitely, and even in perpetuity. That may be appropriate if a donor believes that the need they want to address will forever be present in their community or society, but if they are interested in helping resolve an issue, say within their lifetime or even a generation or two, other approaches are worth considering.

How endowments work

There are a few factors that influence the growth and performance of an endowment, most notably the rate of return on the invested funds and the cost of administering the funds. Some endowments are also designed to not only keep their initial capital value but to also grow over time, so they at least keep pace with inflation. In these cases, the real value of funds available for disbursement each year does not fall behind the escalating cost of living.

To illustrate the implications, consider the following example and assumptions*:

Amount of initial gift:	$1,000,000
Gross average annual return on investment:	8.0%
Net annual amount available for disbursement:	5.0%
Annual administrative and investment fees:	1.0%

* *Note that the values used here will differ across charitable and other organizations that manage endowments on behalf donors and charities. These values have been chosen for illustrative purposes.*

Figure 1

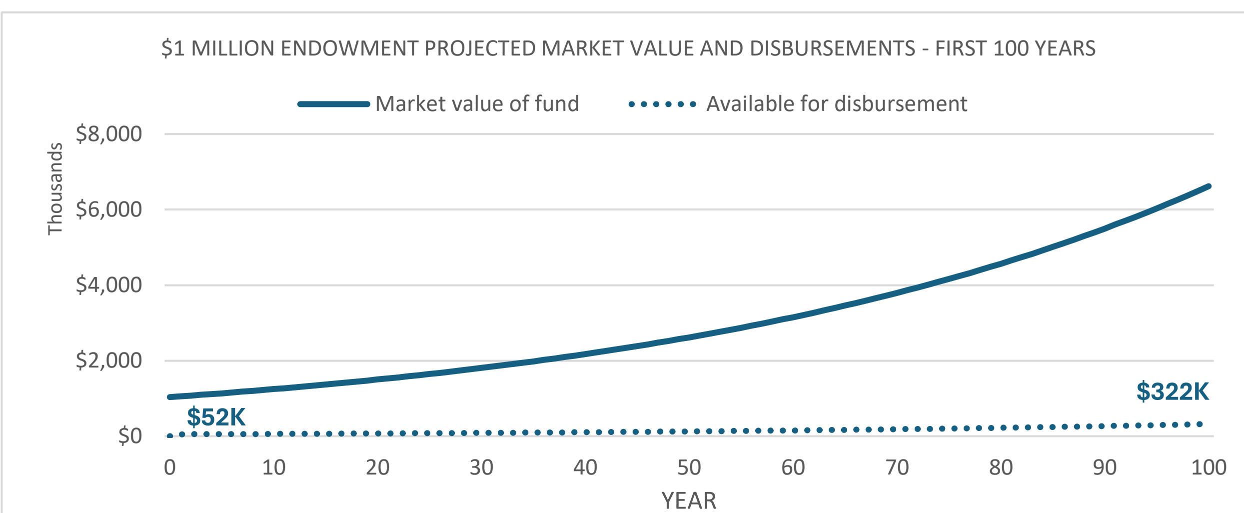
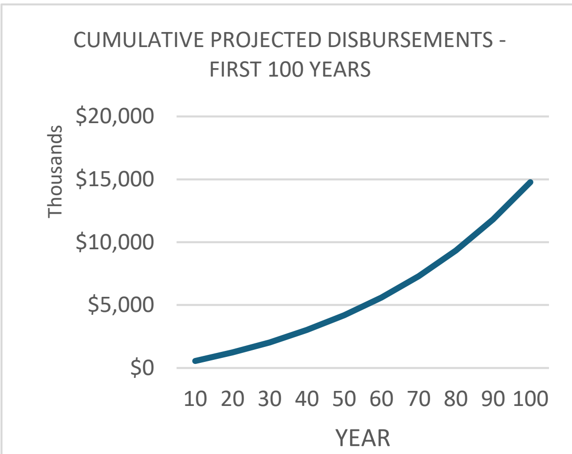


Figure 1 shows that an initial investment of $1 million in an endowment is projected to grow to a market value of over $6 million[ii] after one hundred years. During the same period, annual disbursements grow from around $50,000 per year to over $300,000 per year. By the end of a century, the cumulative value of disbursements will reach almost $15 million (see Figure 2).

Figure 2

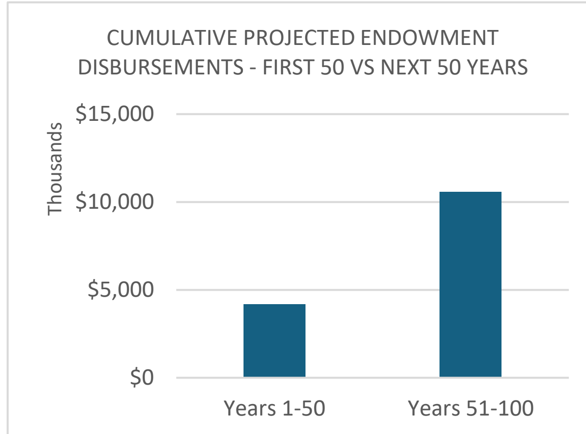


The issue with basic endowments

Endowments, over time, can generate a great deal of expendable income to help address charitable purposes, but if a donor's intent is for timelier impact, a conventional endowment is not the right answer. If we take the 100-year example above, about $4 million (28%) is available for disbursement in the first fifty years of the fund's life, while over $10 million (72%) is available during the next fifty-year period (Figure 3).

Taken further, the first one hundred years of a conventional endowment is just a start. Extending the analysis into future centuries simply worsens the issue, deferring available spending (and impact) indefinitely. Because of their structure, endowments are better able to address future concerns than the concerns of today.

Figure 3



How many donors, if asked, would truly be concerned that their gift still delivers income and impact hundreds or even thousands of years from now? Further, it is difficult to figure out what issues will be among the most pressing far into the future. It is important for donors to consider this to make a well-informed decision about giving.

No crystal ball

Predicting what the most pressing needs will be one hundred years from now is like expecting that a donor in 1924 could predict the most pressing issues of today.

The risk of deferred impact or irrelevance

Building on the above example, assume a donor is interested in addressing inequities that affect historically disadvantaged and marginalized members of society. Establishing an endowment, where significant funding is deferred far into the future will simply defer impact. If we believe funding can contribute to finding solutions, why not distribute more money over a shorter period (a generation or two) to drive positive change faster?

Take another example: funding breast cancer research. If a donor believes it is *possible* that a cure or effective treatment could (or must) be found within 30 years, why not provide funding in a way that increases the likelihood of that goal being achieved?

Another risk with endowments is that their defined purpose may not be relevant in the future. In the example of supporting breast cancer research, if a cure is found for breast cancer within 30 years, will it be possible to repurpose the funds that remain in the endowment? Unless provisions have been made, these funds can be left unspent and "stranded".

Universities and other charitable organizations have had to seek legal remedies to allow stranded endowment funds to be repurposed[iii,iv]. It is unlikely that any donor would be pleased to see their gifts unused or directed to unrelated purposes.

Goals and timelines matter

In 1962, U.S. President John F. Kennedy declared the intent to land a man on the moon and bring him safely back to earth within the decade. It was viewed as an ambitious, even audacious, goal.

$28 billion was spent between 1960 and 1973 to develop the Apollo space program. What if those funds had been endowed rather than spent out?

Whether that money was endowed up front or over time, the project would have received somewhere between $8-18 billion less to spend over those 14 years.

Kennedy's goal may still have been achieved, but it would have taken a lot longer.

Structuring endowment fund agreements

After consideration, if setting up an endowment is a donor's chosen option, gift agreements and endowments can be structured to mitigate the risks outlined above.

Many charitable institutions include a "variance clause" or similar terms in agreements like this, for example:

"(Name of charity) may revise or amend the terms of this fund if it becomes difficult to achieve the original purpose of the fund. In making such revisions or amendments, (name of charity) shall consider the general spirit and original intent of the donors."

This is a useful provision that might allow an institution to redirect funding for breast cancer research to research targeted at other forms of cancer. If the original donor were still alive, they could be consulted, and the agreement could be amended to reflect this change. If, however, the donor is no longer living and has not left more explicit instructions, the decision would be left to the charitable organization. This may be fine but does not guarantee that the new purpose would be in alignment with the donor's original intent.

A donor can also consider building specific provisions into a gift agreement at the outset; for example, stipulating the fund be "un-endowed" (wound down) and disbursed either at a specified point in the future or when certain conditions are met (e.g., a cure is found, or the problem solved). Deciding how funds should be disbursed in such cases could be pre-determined and delegated to the charitable organization or family successors, although both options are far from perfect. With every passing generation, the true spirit and intent of a gift can dilute.

Left without such provisions, endowments can go on in perpetuity and, while delivering more money for disbursement each year, push an extraordinary amount of capital into the future, either unspent, or potentially applied to purposes without considering the donor's original intent.

Aligning gift structure with impact horizon

Due partly to tradition and to a lack of innovation in the charitable sector, endowments are often offered as the default approach and the only alternative to fully expendable gifts.

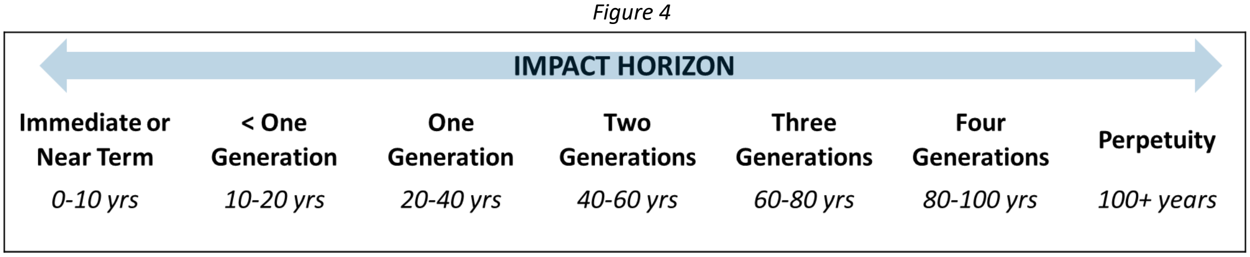
Before settling on gift structure, donors should be invited to "step back" and reflect on what they genuinely want to accomplish through their philanthropy, and over what period. Once that is decided, they can then collaborate with advisors and charitable organizations to align their gift structure with a targeted "impact horizon" (Figure 4).

donor concerned about solving this problem would adjust their giving accordingly.

What about a problem that could take a generation (20-40 years) to solve? Back to the example of breast cancer. It is the most common cancer among North American women, with one in eight expected to develop it within their lifetime[v]. While the death rate from the disease has been declining gradually over time – mainly because of better early detection techniques and practices – there is still no cure or fully effective treatment. If we believe a cure is possible, although there is no guarantee, why not "place a bet" that it can be found within a generation? Spending more money sooner will accelerate the pace of research and may increase the likelihood of finding a cure.

Unless we believe a problem can never be solved, why choose to address it by spreading the funding out indefinitely?

Figure 4



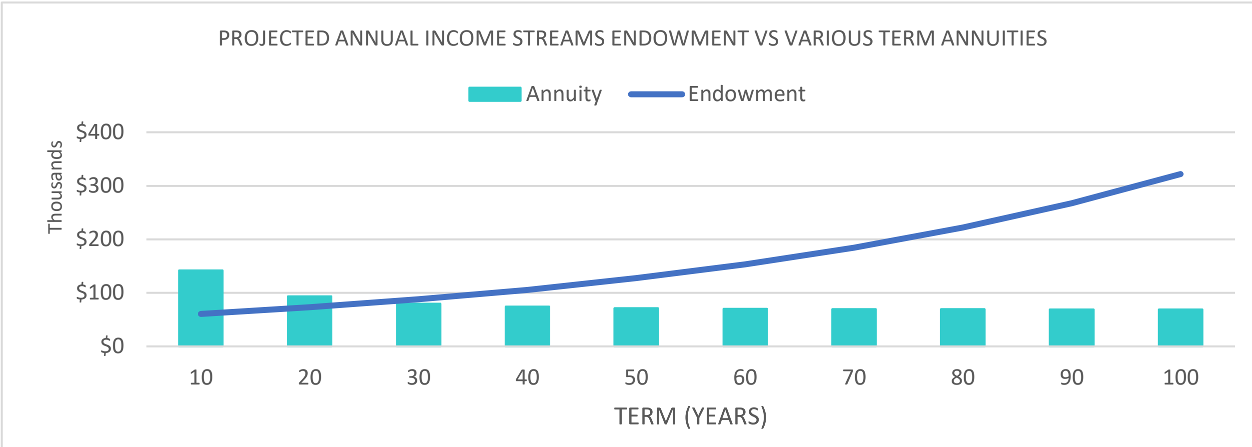
Take as an example a small, isolated rural community that for generations has not had access to potable water. Further, assume that a charitable organization with expertise in this area has a compelling plan to solve this problem within ten years, provided required funding is available. If a donor is passionate about this issue, they would likely choose to have their gift fully disbursed within the project timeline. They could decide to have their gift spent over a longer period or endowed, but that may leave members of the community waiting that much longer for clean drinking water. It is reasonable to assume that a

Annuity or 'spend down' funds

In cases where neither a fully expendable gift nor an endowment aligns with a donor's desired impact horizon, an annuity, or "spend down" gift structure may be best.

Annuities are commonly known as financial instruments subscribed to by individuals to deliver a combination of income and a portion of capital over a set period to support the funder in retirement. Planned well, the money lasts through the balance of the funder's life and even beyond into their estate.

Figure 5



This same approach can be applied in philanthropy to allow a much greater cash flow to charities, sooner. Consider our original example and assumption of a $1 million gift invested by or on behalf of the donor or charity as a 100-year annuity, as compared with an endowment.

As shown in Figure 5, the amount of annual funding available for disbursement declines as the term of the annuity increases. For example, a ten-year annuity will pay out about $140,000 per year each year, and then expire. In contrast, a one-hundred-year annuity will pay out about $70,000 per year before expiring at the end of that term.

So where is the break point at which it may make more sense to invest in an endowment versus an annuity?

See the Appendix for an examination of the relative differences between an endowment and annuities over various terms (10, 20, 30 and 40 years).

The analysis shows that, for donors who are focused on driving more change or making impact in the nearer term (less than 30 to 40 years), an annuity is a better approach. For longer impact horizons, an endowment may be a better solution.

Hybrid structures

Although some charitable organizations may not proactively present a broader range of gift structure options, there is no reason they cannot be explored in the interest of aligning them with donor impact goals.

Hybrid funding model A (Figure 6)

For example, a gift could initially be structured as an annuity and then converted to an endowment, or concurrently be used to set up a term-limited annuity coupled with a more conventional endowment. Either approach may be appropriate in a case where a charitable organization has plans to establish a new program that required more funding up front, followed by a longer period of sustained funding.

In this case, a $1 million gift is provided and structured as $750,000 endowed and $250,000 in a five-year annuity to address the upfront costs related to setting up the project.

The result (depending on actual fund performance) is that the project would receive around $100,000 in funding for each of the first five years and followed by an indefinite stream of sustainable funding in the range of $40,000 per year growing to almost $55,000 per year within twenty years (and continuing to grow beyond that).

Hybrid funding model B (Figure 7)

Consider a project intended to build gradually over time but may not be needed forever. The opposite approach, involving an endowment that is then converted to an annuity, may be worth considering.

In this example, a $1 million gift is endowed at the outset, generating $50,000-$60,000 per year for the first ten years. During that time, the market value of the fund will have reached about $1.2 million, which is then converted to a 40-year annuity, paying out about $92,000 per year.

The point is that gifts can be structured in whatever manner is predicted to "best get the job done" as long as both the donor and charity are prepared to get a little creative.

Choosing the right gift structure

There is nothing inherently right or wrong about choosing an endowment over an annuity or other hybrid models. Concerns arise when a donor is not fully informed about the options and their implications. See Table 1 for some advantages and disadvantages of each approach.

Figure 6

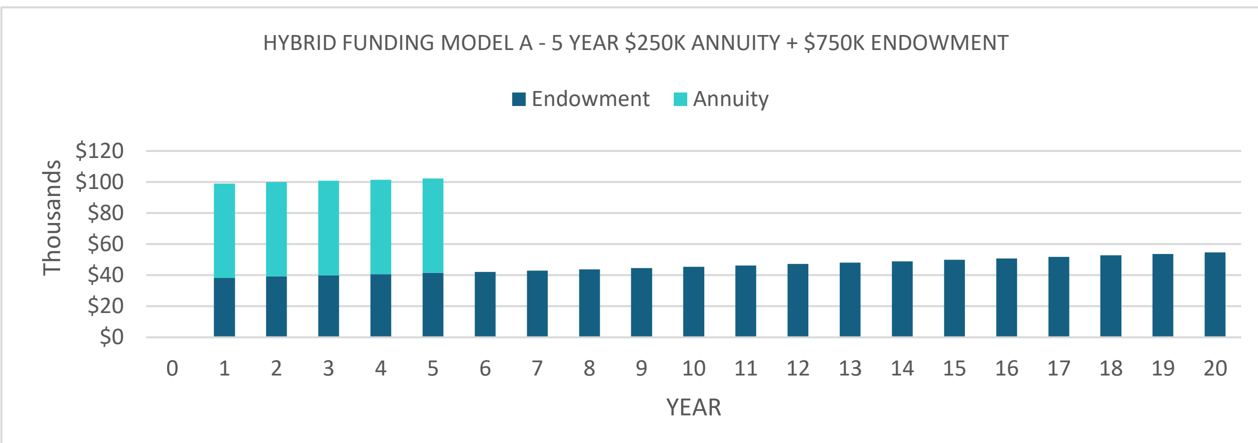


Figure 7

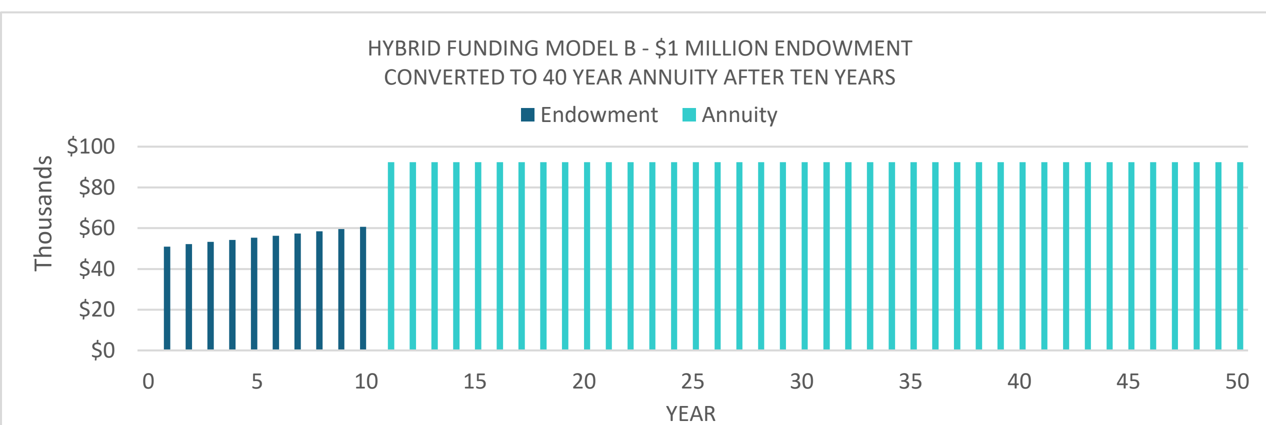


Table 1: Some Advantages and Disadvantages of Endowments and Annuities

	ADVANTAGES	DISADVANTAGES
ENDOWMENT	• Ensures funding for targeted purpose(s) will always be available. • Recognition may endure – sometimes indefinitely - inspiring future generations.	• Relatively little of the fund is spent each year, which could leave solvable problems unsolved. • The targeted purpose of a gift may not be relevant in future. • The spending of relatively large amounts of capital is deferred indefinitely, which may defer impact.
ANNUITY	• Provides for greater disbursements in earlier decades, driving more impact sooner.	• Fund expires with the term of the fund. • May be too unconventional for charities prioritizing endowment growth.
HYBRID	• Maximizes flexibility in aligning funding with purpose.	• May be too complex or unconventional for certain charities or situations.

The $1 million questions donors should ask

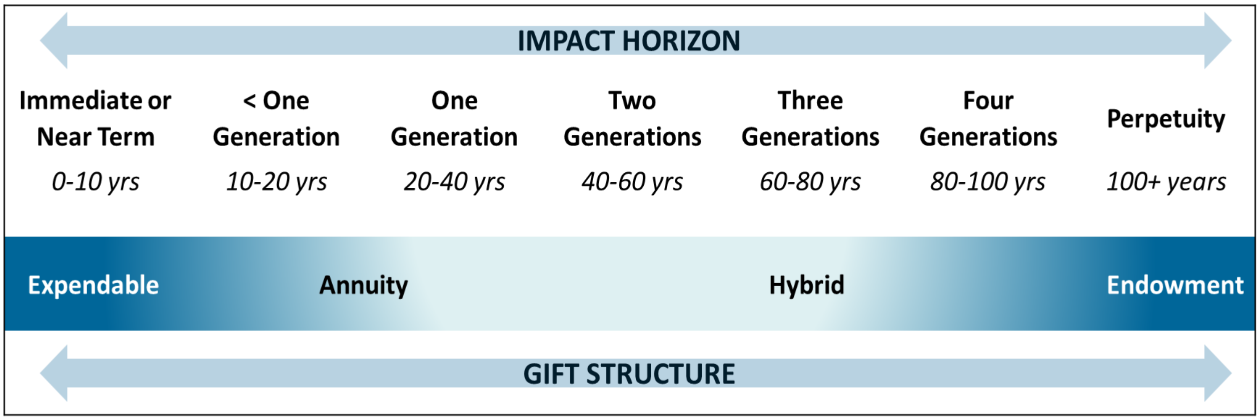
What impact do I want to make, and over what period?

Is this an issue that may go on forever, or is there a possibility that it can be resolved within a certain timeframe?

Does the charity I am considering supporting have a plan that gives me confidence the they can make a significant difference? If so, what are their cash flow needs over time?

What is the best way to ensure my gift is structured to best support the plan?

Figure 8



Choosing the right approach – an endowment, annuity or some hybrid arrangement is best informed by the donor's targeted impact horizon, as shown in Figure 8.

It may be helpful to think of impact in *generational* terms. If a donor wants to maximize impact within one or two generations, an annuity may be a better fit. Looking beyond two generations (think of this in terms of children's, grandchildren's, or great-grandchildren's lifetimes), and endowment is more likely more suitable, if thought and care is taken in defining the terms.

Objections and other obstacles

It is not unusual to meet headwinds when taking an unconventional approach to giving. These may present as organizational 'policy' and/or a reluctance to allow annuity funds to be managed in the same pool as endowments. While it is true that market returns are more predictable over the long term, if the donor is willing to accept the added risk related to a shorter investment time horizon, there is no reason an annuity fund cannot be managed in the same pool and enjoy the same annual returns as an endowment.

Many charitable organizations and fund managers will welcome the opportunity to work with donors in developing creative gift structures, but some more established institutional charities may be less enthusiastic. That is sometimes based on tradition and conservatism and/or dated perspectives on effective fundraising.

Historically, for example, university governance structures were designed to provide oversight of endowments where the goals are to preserve capital and even drive real growth in fund value (i.e. outpacing inflation). The primary performance metric in these situations is the market value of the endowment fund over time. That is unlikely to be a donor's key metric.

Setting up a fund designed to maximize impact over a prescribed period, rather than focusing more on growth, can put a donor at odds with the goals of investment committees and finance departments at some institutions.

This is not a problem when a donor makes an informed choice to make sustainability of funding the primary goal, but – as outlined throughout this paper – that is not every donor's goal, nor is it necessarily in the institution's best interests.

What if the primary performance metric for philanthropic endowment funds was related to impact made rather than fund value?

Astute institutional leaders will easily see the benefits of applying more flexible practices to the management of donor-provided funds, but it will take some time for this change to occur unless equally astute donors drive the discussion.

Caution

Donors should be cautious when considering advice about giving from anyone who benefits from not having the money spent.

In the meantime, if donors meet resistance to more creative funding structures, they can consider setting up a charitable fund managed by a third party (like a community foundation) and having the prescribed amount of funding distributed annually.

Finally, donors should be cautious when considering advice about philanthropy from any person or organization with a vested interest in having money retained rather than given away. This includes professional advisors whose compensation is directly tied to the value of assets held under their management. Most astute and independent-minded advisors will not get hung up on this – they will see that helping their clients make greater impact and derive more fulfilment is in everyone's best interests.

There is little reason to believe that spending money on philanthropic purposes faster will run the well dry. Consider that, by 2022, the top one hundred university endowment funds in the United States and Canada were valued at $674 billion[vi], and that number, *by design*, is forecast to grow indefinitely. More broadly, there was approximately $1.7 trillion in the endowments of nonprofit organizations in the United States as of the end of 2017, based on publicly available figures.[vii] At the time, that was as much as the gross domestic product of Canada.[viii]

A word on market risk

Even the best financial models cannot accurately predict the impact of market risk. Many donors and charities will recall the market downturn in 2008, which left many newly established endowments "under water", which in many cases prevented income from being disbursed for a year or two. Over time, of course, markets recovered, and these funds started to generate income again. When basing giving and investment decisions on predictions, it is prudent to consider how likely it is that market performance over the next twenty years will mirror the last twenty.

Conclusion

There are significant, even existential, societal issues facing humanity today (hunger, disease, homelessness), yet trillions of dollars tucked away in endowments that would be sufficient to solve at least some of these problems. With increasing surplus wealth available and its transfer to successive generations, it is not likely that the world will ever run out of money that is *already* set aside for philanthropic purposes.

Families with the financial capacity and inclination to help others can accelerate the pace of positive change in communities and society, but sometimes established and common practices lead to unintended consequences and impact falling short of potential.

While the traditional approach to endowing philanthropic gifts serves a purpose, donors may drive greater impact and derive more fulfillment by taking a more deliberate approach, in partnership with the charities they wish to support and advisors with whom they work, to align gift structures with the timeframes within which they wish to see impact made.

There is nothing inherently wrong with establishing an endowment when it is a fully informed choice. Incorporating mechanisms to ensure it remains relevant, can be repurposed, or wound down, with clear accountabilities assigned to the parties can provide some comfort.

They key is to start with the "what, why, and when?" of giving, not the "how?".

Finally, how often do we hear "you have to spend money to make money"? Well, you must also spend money to make impact.

[i] Broadly defined, a donor advised fund is a charitable giving vehicle. It is initially established through an up-front donation by a donor – such as an individual philanthropist or family – to an independent organization, typically a foundation or financial institution. While the donor advises how funds are distributed, all administrative, operating and governance matters remain the purview of the independent organization. *Source: Imagine Canada*.

[ii] Note that even the slightest variation in the assumptions (rate of return, fees, payout percentage) can have a dramatic. impact on these values but does not change the outcome of the analysis since the assumptions impact the performance of both endowments and annuities.

[iii] Avila University asks a court to override donors' restrictions amid money challenges, Kansas City Beacon, September 26, 2023.

[iv] Charitable Organizations: Access to Endowments and Restricted Funds during the COVID-19 Crisis – A Practical Primer, Paul Hastings LLP, May 2020.

[v] Canadian Cancer Society and National Breast Cancer Foundation (U.S.).

[vi] National Association of College and University Business Officers and TIAA.

[vii] How Much Money Is in Nonprofit Endowments in America? Capital Research Centre, 2020.

[viii] World Bank.

APPENDIX

Comparing Annuities to Endowments over 10-, 20-, 30- and 40-Year Terms

The projected amount of money available for disbursement from an annuity versus an endowment over varying periods of time can be estimated and compared. The following charts show the relative impact over four different time horizons.

10-year impact horizon: As shown in Figures A and B, there is a significant difference in available spending over the first ten years when comparing a $1 million gift endowed vs. structured as an annuity. If it were of paramount importance to solve a problem or address an issue within this time horizon, one might choose an annuity because it is forecast to deliver $1.4 million, compared to an endowment which would deliver $511,000. The difference of $859,000 (154%) is substantial.

That said, the annuity fund would be fully depleted at the end of the ten years, while the residual value of the endowment would be $1.2 million, which could be repurposed or continue to provide income for spending.

Figure A

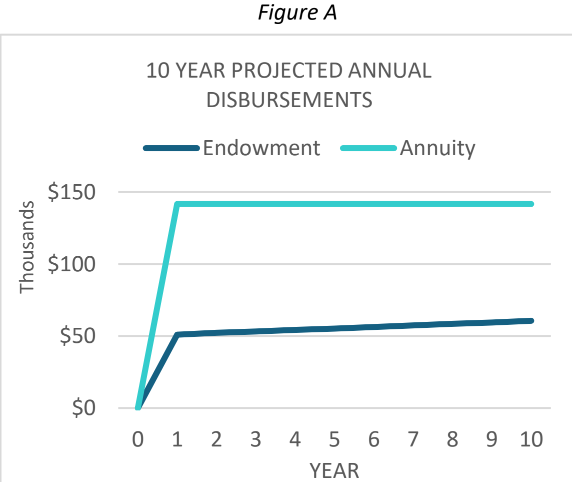
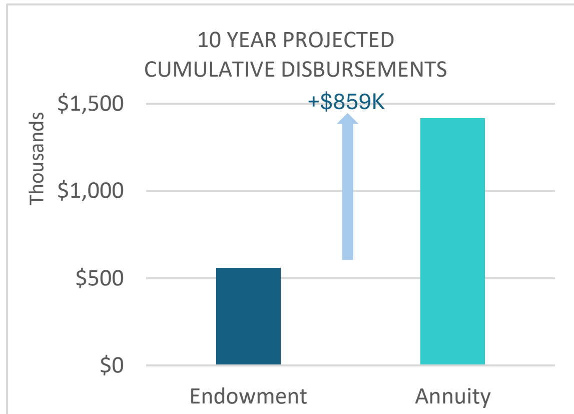


Figure B



20-year impact horizon: In this example (Figures C and D), note that there remains a smaller, yet still material difference of $643,000 (52%) more delivered from an annuity. If the purpose of the fund is to solve a problem in that period, $600,000+ dollars in extra spending could make a difference.

In this case, the remaining market value of the endowment would be around $1.5 million, illustrating that the advantages of an annuity start to diminish over time.

Figure C

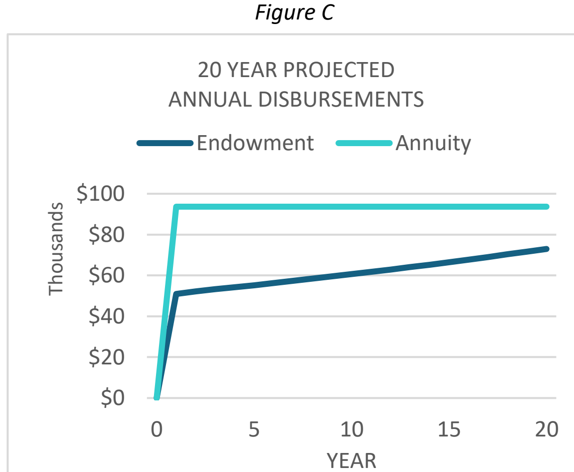
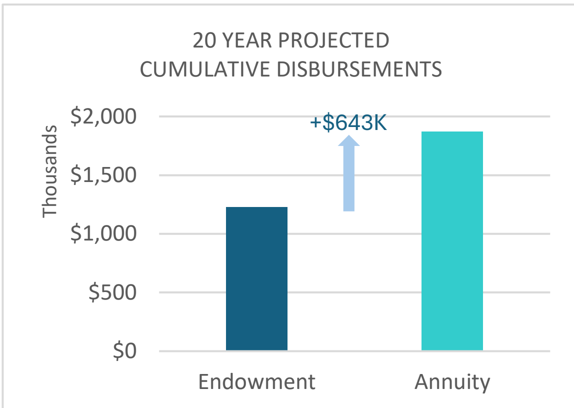


Figure D



30-year impact horizon: As the targeted impact horizon approaches 30 years, the gap between disbursements available through the two methods continues to narrow (see Figures 7a and 7b). The annuity will still have generated +/- $350,000 more than the endowment over the period, but annual returns on the endowment start to surpass disbursements from the annuity. Plus, at the end of this period, the market value of the endowment will be around $1.7 million.

Figure E

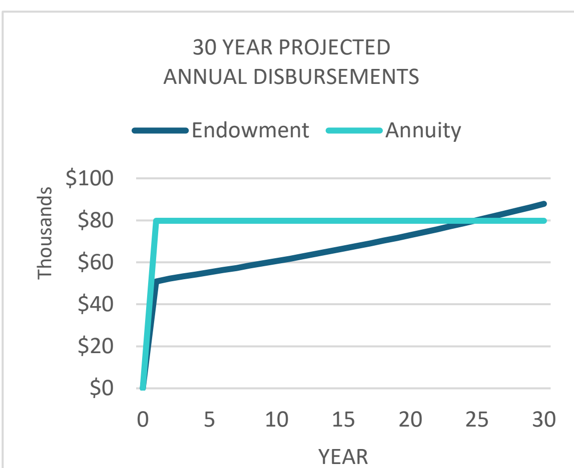
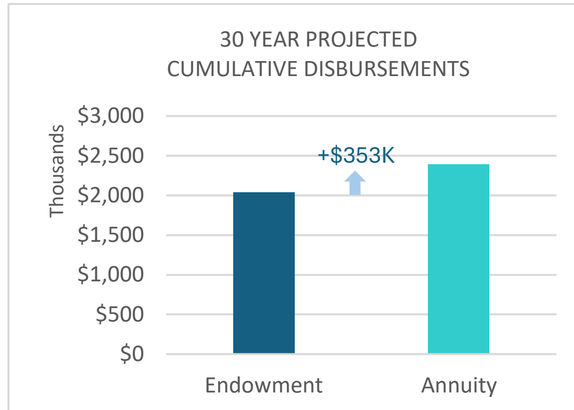


Figure F



40-year impact horizon: Finally, if we extend the analysis another decade, to 40 years, the cumulative funding from the endowment exceeds that from the annuity (see Figures 8a and 8b).

The endowment will have generated about $50,000 more than the annuity during the period (really a rounding error given the assumptions), but of course most of those funds would have only been available during the latter part of period.

Figure G

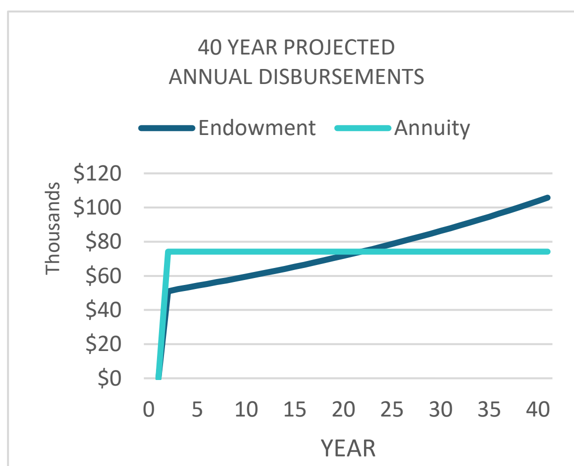
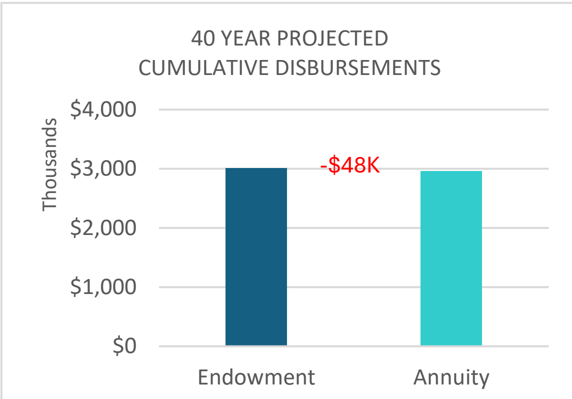


Figure H



In the above examples, any apparent advantages of annuities diminish as the term increases. Taking the 40-year term example, there is negligible difference in the cumulative amount of funding available between endowments and annuities during the period. However, as shown in Figure I, an annuity delivers around $250,000 more funding than the endowment in the first 20 years.

Conversely, the over the course of the next 20 years, the endowment delivers about $300,000 more than the annuity.

Depending on the gift purpose, it may make more sense for the donor to "front end load" available funding to enable more resourcing earlier. Again, it comes back to the donor's impact horizon and the substance of a charity's plan to drive change or make impact.

Figure I