Endowments

Creating an endowment can be an important strategy to set aside funds for the future, and may be a hallmark of financial sustainability. However, creating an endowment is not the right approach for every nonprofit, so it is important to understand what the advantages are, and also what the administrative and fiduciary requirements are to properly maintain an endowment over time.

To start, what exactly are endowments? Endowments may generally be described as assets (usually cash accounts that are invested in equities or bonds, or other investment vehicles) set aside so that the original assets (known as the “corpus”) grow over time as a result of income earned from interest on the underlying invested funds. The corpus may also be added to over time. Endowments are commonly used by large institutions, such as universities and hospitals, but also may play a role in any charitable nonprofit’s financial management and/or revenue strategy.

- Endowments are not the same as reserve funds. An endowment usually implies that some or all of the use of the endowed assets are *restricted* in some way. Most endowments are designed to keep the principal corpus intact so it can grow over time, but allow the nonprofit to use the annual investment income for programs, operations, or purposes specified by the donor(s) to the endowment or the board of directors.

The corpus of an endowed fund is generally not used to fund annual operating expenses. Instead, the goal of most organizations with endowments is to allow the corpus to grow without withdrawals so that the underlying corpus increases in value over time, and the interest earned is available every year for the stated purpose of the endowment. (Of course, one of the stated purposes of an endowment could be to use the interest to “contribute to the annual operating revenue of the organization.”)

When an endowment is created there are generally guiding documents such as a trust instrument or other written documentation of donor intent – or simply a corporate resolution by the board of directors – that establish the endowment and express the guidelines. The guiding documents may literally restrict the use of the endowed funds (referred to as a “restriction”).

- For example, the guiding documents may provide that interest earned each year may be used only for certain specified purposes.
- If the donor(s) does not articulate a specific purpose, the board of directors may express how the investment income may be used in a corporate resolution.

What to consider before creating an endowment

- By establishing an endowment, a nonprofit may send a signal to the community and donors that the organization is thinking long-term and building assets for its own future sustainability.
- On the other hand, there are some endowments that are so very large (literally billions of dollars) that the public may wonder why the organization doesn’t spend the funds on current needs.
- The growth of the endowment and the amount of income each year that is available to the nonprofit will depend on how well the underlying investments perform. The nonprofit’s board of directors may not want full responsibility for oversight of the fund’s market performance. In such cases nonprofits generally choose to hire a professional investment firm/money manager to recommend investment vehicles and provide administrative support for the invested funds.

Questions to ask

- How much will it cost the nonprofit annually to manage the endowment, either on its own (bank fees, etc.) or through a professional fund manager/investment manager?
- Is the board of directors comfortable creating a restriction on the use of the assets, or should there be more flexibility in the permitted use(s) of the annual income? How will restrictions, if any, be documented?

Practice Pointers

- Nonprofits with endowments generally also have an investment policy to govern how the endowed assets will be invested.
- Withdrawing money from the corpus is sometimes referred to as "invading the corpus." This is generally prohibited, absent specific authorization from the board to do so.

Additional Resources

- Endowments Definition (Investopedia)
- Endowment for a Rainy Day (Stanford Social Innovation Review)
- Five steps to starting an endowment: even smaller nonprofits can (Candid)
- Should Your Nonprofit Build an Endowment? (Nonprofit Quarterly)
- The Truth About Endowments (Chronicle of Philanthropy)