

This article presents general guidelines for Georgia nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.

Invading Your Endowment in Tough Economic Times: What You Need to Know

In these tough economic times, many nonprofits are struggling financially and looking for alternative funding options. For organizations that have endowments, you may be wondering whether and how much your endowment funds can be used to keep your organization afloat. While a lot depends on the specifics of the endowment, this article is intended to provide an overview of some of the factors and risks nonprofits should consider before accessing, borrowing, or otherwise using funds from an endowment.

Legally speaking, an endowment is a donation of money or property to a nonprofit organization that uses the investment income generated from the money or property. Sometimes the donor also identifies specific restrictions on whether the donated assets may be spent or sold and how the investment income is to be spent. The donation is often memorialized in a written document (“endowment agreement”) explaining the wishes of the donor. An endowment does not include, for example, segregated accounts, board-designated or “quasi” endowments, or reserve funds.

Restrictions on Endowment Funds

In considering whether to use endowment funds, a nonprofit must look first at what restrictions the endowment has on its use. For instance, the endowment agreement may provide “these funds may only be used for nonprofit’s housing program” or “the corpus of this endowment may not be spent and only 5% of the income may be used for the nonprofit’s housing program.” If the endowment agreement provides specific restrictions on how the funds may be used, those restrictions govern.

If the endowment agreement is more general and only says, for instance, “spend only the income” and nothing about how the funds may be used, then spending is governed by the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

One of the primary goals of UPMIFA is to make sure nonprofit boards act prudently when making decisions about endowment fund spending. In making a decision to use or keep assets in a way that is not established by the agreement, GA UPMIFA law states the nonprofit shall act

Dated: 6/30/2020

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in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors:

- (a) the duration and preservation of the endowment fund;
- (b) the nonprofit and endowment fund's purposes;
- (c) general economic conditions;
- (d) the possible effect of inflation or deflation;
- (e) the expected total return from income and the appreciation of investments;
- (f) the nonprofit's other resources; and
- (g) the nonprofit's investment policy.

These factors should be weighed considering the need to sustain the nonprofit in the present, while keeping in mind the need to preserve the fund to support the nonprofit in the future. For example, during the 2008 recession, after considering the UPMIFA factors, many organizations determined increased spending from general endowment funds was prudent under the circumstances.

Releasing or Modifying Endowment Restrictions

In unexpected, tough economic times, nonprofits may be able to release or modify the endowment restrictions to allow spending that would otherwise be prohibited or not prudent.

Endowment Agreement Procedure:

Some endowment agreements have procedures for the nonprofit to release or modify the spending restrictions. Since the 2008 recession, many endowment agreements now include emergency invasion provisions to help the nonprofit during tough economic times. If the endowment agreement doesn't have an emergency invasion provision, using endowment funds in a prohibited manner or, for general use endowments, in a way that would not meet UPMIFA's test, is risky for the nonprofit. Potential consequences include upsetting donors, harming the nonprofit's reputation, or even legal action being taken against the nonprofit. Even if an emergency invasion provision exists, it is still important for a nonprofit to communicate its situation and plan to the endowment's donors.

Donor Consent (preferred):

Where the endowment agreement does not have a particular procedure, nonprofits can ask donors to agree in writing to release or modify spending restrictions. Receiving donor consent is the best way to release or modify restrictions, though it may not work for all endowments and is

much simpler for endowments given by a single donor (family, foundation, etc.) than endowments with a large number of donors. Further, some donors may be deceased, adding significant complications.

Court Modification:

Where it's hard or impossible to obtain donor consent, going to court to change the endowment requirements is always an option, although it is much more expensive and time-consuming.

Borrowing Against Endowments

Some states allow nonprofits to “borrow against” endowments by taking or invading the endowment (with the promise to repay the funds with interest) and using the funds to pay for expenses not permitted by the fund’s restrictions, but others do not. Georgia UPMIFA law is silent on borrowing against endowments but, in general, will look to what other UPMIFA states are doing in this area. Thus, borrowing against an endowment is risky.

Pledging Endowment Funds as Collateral for Loans

Some nonprofits may be interested in using endowment funds as collateral for an outside loan in the hopes of boosting the nonprofit’s credibility and obtaining a lower interest rate for the loan. Georgia UPMIFA law is silent on pledging endowment funds as collateral and will look to what other UPMIFA states are doing. So, attempting to pledge endowment funds as collateral is risky. Also, not all lenders accept endowment funds as collateral. For those that do, the nonprofit has the added risk of substantial damage to its reputation and its donor relationships if the nonprofit defaults on the loan and the lender takes the pledged endowment funds.

Conclusion

Given the extraordinary circumstances the world is currently facing, many nonprofits are facing unanticipated financial challenges, but there may be ways to use assets you already have to help.

For any of the options discussed here, three important things to keep in mind to protect your nonprofit and board are: (1) when in doubt and whenever possible, discuss your situation with the endowment donor to determine the best solution for your nonprofit’s needs, (2) work with trusted advisors in making these decisions, and (3) be sure to keep detailed, organized records of all board decision-making for any endowment fund spending.

If your organization is interested in the possibility of accessing funds from your endowment, please contact your accountant, financial advisor, or PBPA attorney for assistance.