



COMMUNITY
FOUNDATION
of Northeast Alabama

How To Start An Endowment Fund

Most not-for-profit organizations have a variety of funding mechanisms such as memberships, annual appeals, capital campaigns, special events, and planned giving programs. Another component is the endowment fund building a permanent source of dependable income for an organization. This permanent pool of assets is intended to both grow and help financially stabilize an agency.

Whenever a not-for-profit board considers establishing an endowment fund, they should do so within the true definition of endowment. **To endow is to “enrich with property by gift or bequest for a permanent purpose.”** Legally, there is no single definition; however, a New York court defined endowment as “the bestowment of money as a permanent fund, the income of which is to be used in the administration of a proposed work.” With similar language, the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and the Financial Accounting Standards Board (FASB) define endowment, “as a fund comprised of assets to provide income for the maintenance of a not-for-profit organization.

Endowment Purpose: Some of the general reasons often used in support of endowments are:

Tax Incentives: Endowment funds of tax-exempt institutions are themselves exempt from tax; therefore, all the subsequent income and growth of the endowment also accumulate tax-free. Thus, a donor’s gift today can meet future needs when a building must be replaced, new programs are needed, or new services are needed.

Maintaining Liquidity: Income from an endowment can level the peaks and valleys of current fundraising efforts. The less dependent an institution is on federal, state or grant funding, the more resilient it is during adverse economic circumstances. This allows an institution to absorb reductions in current donations without a corresponding reduction in the level of services.

Subsidizing Values: An endowment fund allows the current generation to instill its values in a subsequent generation. Endowment funding is an affirmation that an organization should play a role in the future of the community. It is a statement by donors that an organization has an important mission worthy of sustaining.

Donor Preference: Donors in many cases want to see their gifts, or a portion of their gifts, placed into a permanent fund. Thus, it is very common for donors to give both to annual operations and to an endowment fund. It represents an enduring relationship with an organization and its public mission.

Endowment Size: Once an organization embarks on building a permanent endowment, donors or board members will begin to question its size. Most new endowments should continue to increase until they match the organization's annual operating budget. If the goal is reached in a short period of time, the board may decide to expand the endowment to generate enough income to support the annual operating budget. This is a much more aggressive task.

Other goals may include allowing endowment funds to grow to the point that they can support overhead or a specific administrative expense. Most importantly, the endowment fund is not a rainy day fund or the first place the board turns in an emergency. The board members who establish the endowment should clearly set a policy for future boards to honor.

Starting An Endowment: The Foundation provides not-for-profit organizations the opportunity to establish and administer an endowment fund based on the above endowment definitions. Specifically, these not-for-profit organizations are comprised of 501(c)3 public charities; subsections of the state, such as schools, museums and libraries; religious institutions, private schools, civic groups and associations. Starting an Institutional Endowment Fund is simple, flexible and there are no set-up fees.

The assets will be part of the Foundation's investment pool, which includes a diversified portfolio, professional money management and reduced management fees due to the combined financial strength of the Foundation. The investment policy is based on a long-term horizon with approximately 60 to 70% of the portfolio allocated in highly diversified equities with the remaining 30-40% in fixed income investments. In addition, the Foundation handles all accounting, financial reporting, statement preparation, and audits. The fee for an Institutional Endowment is published in the separate Fee Policy.

The IRS requires that funds within any community foundation be assets of the community foundation. All gifts, contributions, and investment growth are posted directly to the organization's account and are restricted for the charitable use of the agency, institution or organization, as defined in a fund agreement. Once the fund has reached a level to begin meaningful distributions, annual payments based on the Foundation's Spending Policy are made to the beneficiary organization.

Establishing or placing an existing endowment at the Foundation reassures your donors that their contributions are earmarked for a permanent purpose and will only be used for long-term financial support. Also, endowments gain added exposure by being listed as a fund of the Community Foundation and publicized in the Foundation's annual report. In addition, donors can create sub-endowments to support specific programs, causes or services offered by an organization.

The following guidelines and questions are offered to assist in the deliberation process prior to establishing or the transferring an endowment to the Community Foundation:

1. Consider the long-term future of an endowment by addressing the following questions:

- Has the organization defined the clear intended use or the purpose for the endowment?
- How will this “case for giving” be defined and communicated to friends, donors or clients?
- Has every board member agreed to complete an immediate gift, pledge or planned gift to the endowment?
- Has the organization outlined a marketing plan or an ongoing vehicle to continue to fund or grow the endowment?
- Has the institution outlined a process to honor or thank donors?

These steps should be completed before an organization establishes an endowment with the Foundation.

2. The minimum amount required to establish an Institutional Endowment Fund is \$10,000, or \$5,000 with a commitment to increase the fund to \$10,000 within three (3) years. Additional contributions can be added to the fund at any time, in any amount.
3. All gifts to the fund are restricted for the organization’s charitable use only. While co-mingled for investment purposes, the endowment fund receives a separate monthly statement.
4. The IRS requires that all community foundations include a “variance power” as part of all fund documents. This gives community foundations the authority to modify or redirect endowment funds that support organizations that terminate, fail to continue their stated charitable purpose(s) or lack sufficient financial support to sustain an endowment.
5. Distributions from the Institutional Endowment Fund to the agency are based on the Spending Policy. It is recommended that the board of directors for the not-for-profit organization establish endowment fund goals and the terms under which distributions from the endowment will take place.
6. The Community Foundation is not obligated to engage in any direct fund raising on behalf of agencies placing their endowment funds at the Foundation. The Foundation can provide technical, donor development and marketing assistance based on the cost of these services. The Foundation’s Fundraising Policy is available on the website at www.yourcommunityfirst.org.
7. A legal document (the Fund Agreement) is required to establish the Institutional Endowment Fund, which is provided by the Foundation at no cost.

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