



# Playing the Long Game

Everything You Need to Know About Restricted Gifts and Endowments



**Yosef Ziffer, Esq.**

Partner | 410.244.7550 | [yziffer@Venable.com](mailto:yziffer@Venable.com)

**VENABLE** LLP

## Restricted Gifts – In General

- All gifts to charities are inherently subject to certain restrictions – Section 501(c)(3) purposes.
- A restricted gift is subject to additional restrictions, as agreed to between the donor and the charity.
- The restriction could be initiated by the donor or the charity.
- The law will typically protect donor intent. No “bait and switch.”

# Restricted Gifts – In General

- Most typically, restrictions pertain to usage.
- Other types of restrictions – investment of the gift, limits on disposition, etc.
- Ensure that any restricted gift has been fully vetted and approved.
  - Is the organization positioned to use the gift in the manner designated?
  - Comply with provisions of the organization’s gift acceptance policy.

# Gift Agreement

- Document the gift in a signed agreement.
- Key terms: Amount of the gift, payment schedule, permissible forms of payment.
- Clear statement of the restriction(s).
- Alternative use(s)? Changed circumstances?
- Reporting obligations.
- Naming rights and other forms of donor recognition.
- Successor to donor (payment obligation and other donor rights).

# Endowments

- Endowments are a specific type of restricted gift.
- Definition: A gift that, under the terms of a gift instrument, is not wholly expendable by the organization on a current basis.
- Exclusion: Amounts designated by the organization itself (e.g., by the board).
- Endowments may also include usage restrictions, in addition to limits on expenditure.

# UPMIFA

- Uniform Prudent Management of Institutional Funds Act (UPMIFA).
- Model law adopted by nearly all states and D.C., with some variations.
- Replaced a prior model law – the Uniform Management of Institutional Funds Act (UMIFA).
- UPMIFA eliminates prior emphasis on “historic dollar value” of endowments.
- UPMIFA supplements, and does not replace, more generalized fiduciary duties under applicable law.

# Standard for Managing and Investing Funds

- This prong of UPMIFA applies to “institutional funds” generally – not exclusive to restricted funds and endowments.
- Donor can always agree to a separate standard in a gift instrument – but institution should be mindful of terms to which it agrees.
- Manage and invest in good faith, with care of an ordinarily prudent person in like circumstances.
- UPMIFA favors diversifying investments, absent specific reason to the contrary – “modern portfolio theory.”
- Manage and invest pursuant to overall investment strategy.

# Standard for Managing and Investing Funds

- In managing and investing institutional funds, consider relevant factors:
  - General economic conditions
  - Effects of inflation/deflation
  - Tax consequences of investment decisions
  - Role of each investment within broader investment portfolio
  - Expected total return from income and appreciation of investments
  - Other institutional resources
  - Needs of the institution and the fund – make distributions vs. preserving capital
  - Asset's special value/relationship to the charitable purposes of the institution



# Endowment Funds – Appropriate or Accumulate?

- Old approach – “historic dollar value”
  - Created an arbitrary dividing line
  - Ambiguities
  - Skew investment decisions
  - “Underwater” endowments become unusable
- New approach – prudent appropriation for expenditure. Consider relevant factors:
  - Duration/preservation of endowment fund
  - Purposes of institution and the fund
  - General economic conditions
  - Possible effects of inflation/deflation
  - Expected total return from income and appreciation of investments
  - Other resources of the institution
  - Investment policy

# UPMIFA Standards for Endowment Spending

- Rules apply retroactively – including endowments that predate UPMIFA.
- Donor intent can still supersede UPMIFA – if a donor and institution specifically agree to an “income only” (“historic dollar value”).
- Generalized terms (“endowment,” “use income,” “preserve principal,” etc.):
  - Will create an endowment
  - Will not limit the generalized authority to prudently appropriate amounts for expenditure

# Presumption of Imprudence

- “Optional” UPMIFA provision – expenditure in excess of 7% is presumed to be imprudent.
- 7% is not presumptively prudent.
- 7% is measured on the basis of a rolling average of the fund’s balance – determined at least quarterly and spread over a period of at least three years.
- Some jurisdictions that adopted the 7% presumption: New York (over 5 years), California (but not for schools), Maryland (requires AG notice).
- Some jurisdictions that did not adopt the 7% presumption: DC, Massachusetts, Florida, Illinois.

# Release/Modification of Restrictions

- Applies to restricted funds of all types (not only endowments).
- Release/modification permitted if donor consent is obtained. Donor consent should be in a tangible, preservable form.
- If institution does not/cannot obtain donor consent, then it may apply to the courts to release or modify the applicable restriction in certain circumstances.
- Court can agree to modify a restriction on management or investment of a fund in accordance with the donor's probable intention if the restriction:
  - has become impracticable or wasteful;
  - impairs the management or investment of the fund; or
  - should be modified to further the purposes of the fund due to circumstances not anticipated by the donor.

# Release/Modification of Restrictions

- Court can agree to modify a restriction on purpose or use of a fund if the restriction has become:
  - unlawful;
  - impracticable;
  - impossible to achieve; or
  - wasteful.
- Modification of restriction should be in a manner consistent with the charitable purposes expressed in the gift instrument.

# Release/Modification of Restrictions

- In bringing a request to court, the institution must give notice to the attorney general, and the attorney general will be a party to the court proceeding.
- In some states (including New York and California), notice must also be given to the donor.
- In some states (such as Maryland), the court option is available “if the written consent of the donor cannot be obtained by reason of the death, disability, unavailability, or impossibility of identification of the donor.”

# Release/Modification of Restrictions

- Streamlined provision for funds that are “small and old.”
  - Fund has a balance of not more than a statutorily specified amount. (Maryland: \$50K. New York and California: \$100K. DC: \$50K, subject to inflation adjustments.)
  - Fund is at least 20 years old.
  - New use will be consistent with the charitable purposes stated in the gift instrument.
- Costs of court proceeding are deemed prohibitive for these types of funds, so UPMIFA allows an institution to release or modify the restriction upon 60 days’ notice to AG. (In New York: 90 days.)

# Planning Considerations

- Create a separate legal entity to hold the endowment?
  - Benefits:
    - Insulate assets from liabilities
    - Specialized board with fiduciary duties to the endowment
  - Drawbacks:
    - Additional administrative responsibilities
    - Frustration to the board of the operating entity?
- Are restricted gifts inherently protected from creditor claims?
  - “Charitable trust” theory – preserve donor intent



# Planning Considerations

- “Borrowing” from endowment:
  - An organization generally cannot borrow from itself.
  - Not clearly addressed in UPMIFA.
  - Technically, any withdrawal from an endowment will be treated as an expenditure.
  - Possible argument to treat as an “investment” of fund assets.
- Standing to enforce terms of a restricted gift:
  - Generally, state attorney general has standing. Individual donor may not.
  - Donor (or donor’s family) may alert AG.
  - Donor relations always important.

# Case Study #1: Impracticability

## Facts:

- Original restriction has become impracticable – economically or programmatically.
- Example: Fund to sponsor a research fellowship, but fund assets are not sufficient for current market rates.
- Donor is deceased or otherwise unavailable.

## Options:

- If not an endowment, spend down the fund in furtherance of the original purpose and supplement with other institutional funds.
- Depending on fund balance, use UPMIFA exception for small, old funds, or apply to court for a modification.

## Case Study #2: Lack of Documentation

### Facts:

- Long-standing organizational practice of showing funds as endowment.
- Organization does not have paperwork or documentation indicating the identity of the donor(s) or the nature of the restriction(s).

### Options:

- Evaluate facts and circumstances.
- Consider risks – AG scrutiny, reputational, ethical, etc.
- Seek AG consent?

## Case Study #3: Institutional Instability

### Facts:

- Ongoing viability of institution is threatened by unexpected circumstances – e.g., pandemic, litigation, etc.
- Emergency requires significant expenditures in excess of currently available funds.

### Options:

- Remove restrictions on any board-designated funds.
- Increase rate of withdrawal from endowment – but how much?
- Seek donor release of restrictions where possible.
- Borrow – use endowment as collateral?

## Case Study #4: Changed Circumstances

### Facts:

- Donor placed permanent restriction on gift – e.g., donated asset may never be sold.
- Donor is dead, and there are significant factors suggesting that it would be prudent to sell the asset and diversify the investment.

### Options:

- Engage donor's family for political reasons.
- Engage AG's office – explain rationales and steps taken by the organization to evaluate pros and cons.
- Seek court approval of release/modification of the restriction.

---

# Questions?

[yziffer@venable.com](mailto:yziffer@venable.com)

---

410.244.7550

**VENABLE** LLP



© 2023 Venable LLP.

This document is published by the law firm Venable LLP. It is not intended to provide legal advice or opinion. Such advice may only be given when related to specific fact situations that Venable has accepted an engagement as counsel to address.

**VENABLE** LLP