Endowments: The Uniform Management of Institutional Funds Act (UMIFA)

A. What Is An Endowment?

In common parlance, an endowment is a sum of money that is set aside for a charitable purpose, with only the "income" being spent and "principal" being preserved. Typically, a "true" endowment is one established through a contract with the donor. A board-restricted endowment is created when the board takes unrestricted funds and imposes use, spending or other restrictions.

B. What Is UMIFA?

UMIF A is a uniform law which provides rules regarding how much of an endowment a charity can spend, for what purpose, and how the charity should invest the endowment funds. UMIF A has been adopted by 46 states (actually 47 - it has also been adopted in Arizona). Note that individual state statutes may vary from Uniform Law text. UMIF A was adopted in California effective July 1, 1991 (January 1, 1974, for educational organizations accredited by the Association of Western Colleges and Universities). Colorado's version is at Probate, Trusts and Fiduciaries Code section 15-1-1101 and following (see attachment).

C. History

1. Ford Foundation Report: Cary and Bright, *The Law and The Lore of Endowment Funds, p.* 5-6 (1969)

"[T]oo often the desperate need of some institutions for funds to meet current operating expenses has led their managers, contrary to their best long-term judgment, to forego investments with favorable growth prospects if they have a low current yield. [I]t would be far wiser to take capital gains as well as dividends and interest into account in investing for the highest overall return consistent with the safety and preservation of the funds invested. If the current return is insufficient for the institution's needs, the difference between that return and what it would have been under a more restrictive policy can be made up by the use of a prudent portion of capital gains. "

2. For a review of University, College, & Foundation endowment spending policies see: *Real Return, Modern Portfolio Theory, and College, University, and Foundation Decisions on Annual Spending from Endowments: A Visit to the World of Spending Rules,* by Prof. Joel C. Dobris, 28 Real Property, Probate and Trust Journal 49.

3. National Conference of Commissioners on Uniform State Laws adopted UMIF A in 1972. Uniform Management of Institutional Funds Act (U.LA.) S. 1 -11

D. What Are The Definitions I Need To Be Concerned With Under UMlFA?

1. Institution: "an incorporated or unincorporated organization organized and operated exclusively for educational, religious, charitable, or other eleemosynary purposes"

2. Institutional fund: "a fund held by an institution for its exclusive use, benefit, or purposes…"

3. Endowment fund: "an institutional fund, or any part thereof, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument.

4. Gift instrument: "a will, deed, grant, conveyance, agreement, memorandum, writing, or other governing document (including the terms of any institutional solicitations from which an institutional fund resulted)"

5. Historic dollar value: "the aggregate fair value in dollars of (1) an endowment fund at the time it became an endowment fund, (2) each subsequent donation to the endowment fund at the time it is made, and (3) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the endowment fund."

6. Governing Board: institutional fund. "the body responsible for the management of an institution or of an institutional fund."

E. How Much Of An Endowment Can Be Spent Pursuant To UMIFA?

1. "The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, both realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent…"

2. Net appreciation = all income (dividends/interest) + realized gains + unrealized gains.

3. The board's appropriation for expenditure must be "prudent": UMIFA requires the board to "act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use...", and states that the board shall consider (among other factors) the long- and short-term needs of the institution, its present and anticipated [mancial requirements, and general economic conditions.

> Example 1: Donor X donates $100,000 to What's a Matta University's school scholarship fund on the July 1st (the start of the fiscal year). The gift instrument reads: "I give $100,000 to What's a Matta University's endowment for purposes of its scholarship fund." On July 1 of the next year, the school's CFO calculates that the endowment has had an overall return of 15% of which 5% is income (interest/dividends) and 10% is unrealized appreciation of capital. How much is available to support the school's scholarship fund?

4. Pursuant to UMIF A donors can limit the expenditure of net appreciation but it must be *explicit.* Generally, if a donor uses the words income/interest/dividends/rents/issues/profits

after the enactment of UMIF A, "a restriction on the expenditure of net appreciation may not be implied solely from the designation, direction, or authorization, if the gift instrument becomes effective after the UMIFA became applicable to the institution."

Example 2: Same facts as above except donor adds the language "I only want the income from this endowment to be used." What is available for the Board to spend on scholarships?

5. Assuming a charity wants to establish its own spending role (vs. the donor's or the law's), it has to select both the type of spending restriction and the technique.

Types of spending restrictions include:

- Spend all income - the UMIF A standard
- Spend all income in excess of inflation - look to annual inflation, or a rolling multi-year average
- Spend a fixed-percentage of fund balance - a unitrust concept

Techniques include:

- Most flexible- impose no restriction, beyond the preservation of historic dollar value. Board can decide annually how much to spend.
- Least flexible - adopt a specific, binding spending role that the donor adopts at time of gift. This role applies in perpetuity to the donor's contribution.
- Established but flexible - impose a flexible spending rule that the board can amend. In other words, the gift is subject to the Spending Rule as adopted by the Board, but which can be amended from time to time.

F. What About Use or Purpose Restrictions?

1. The purpose of an endowment can be as broad as, or narrower than, the charitable purposes of the organization. Purpose is established via language in the donor's gift instrument and charity's solicitation material.

2. UMIF A provisions:

"With written consent of the donor, the governing board may release, in whole or in part a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund."

If a donor is not available, by reason of "death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution ... or other court of competent jurisdiction, for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund If the court finds that the restriction is *obsolete or impracticable,* it may by order release the restriction in whole or in part. A release, under this subdivision may not change an endowment found to a fund that is not an endowment fund."

3. What if the donor believes the institution is violating the use restriction?

"[T]he drafters of UMIFA paid heed to the concerns expressed in the Ford Foundation report as their final draft of *UMIF A attempted to offer as much relief as possible to charitable institutions*, without any mention of concern regarding a donor's ability bring legal action to enforce a condition on a gift" Italics added. *Carl J. Hertzog Foundation, Inc. v. University of Bridgeport*, 699 *A.2d* 995 *(Conn.* 1997) at 1000.

"[W]e find no support in any source for the proposition that the drafters of either UMIF A or CUMIF A intended that a donor or his heirs would supplant the attorney general as the designed enforcer of the terms of completed and absolute charitable gifts." *Hertzog Foundation*, supra, at 1001. See also *Garland v. Beverly Hospital Corp., Ct. of App., No. 98-P-192 (Mass.* 1999).

4. What if the charity raises more money than it needs for the restricted purpose?

5. I recommend that all gifts with a "restricted use" contain a "savings" clause: If at any time in the judgment of the Board of Directors it is impossible or impracticable to carry out the above purpose, the Board of Directors shall determine a purpose as near as is practicable to the above purpose.

G. How Should A Charity Invest Its Endowment?

1. Investment is a matter of state law. In California, the Board is subject to the rules on prudent investments as set forth in both the Corporations Code and UMIF A (which unfortunately are not entirely consistent).

2. The .Corporations Code provides that in making investments, a. Board must "avoid speculation, looking instead to the permanent disposition of the funds, considering the probably income, as well as the probable safety of funds." This is an "old fashioned" and fairly conservative statement of the prudent investor rule.

3. UMIF A articulates the modem portfolio theory of prudent investment. It provides that the Board may invest in real or personal property mortgages, deeds of trust, stocks, bonds, debentures, and other securities. It may participate in a pooled income fund, mutual fund, or other forms of common funds.

4. UMIF A also provides a standard of care in investing, which is comparable to the modem prudent investor rule:

"When investing. . . and delegating investment management for the benefit of an institution, the members of the governing board shall act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the institution. In the course of administering the fund pursuant to this standard, individual investments shall be considered as part of an overall investment strategy.

In exercising judgment under this section, the members of the governing board shall consider the long- and short-term needs of the institution in carrying out its. . . purposes, its present and anticipated financial requirements, expected total return on its investments, general economic conditions, the appropriateness of a reasonable proportion of higher risk investment with respect to institutional funds as a whole, income, growth, and long term net appreciation, as well as the probable safety of funds."

H. How Is An Endowment Established?

An endowment can be established unintentionally: for example, a donor gives in response to a solicitation which discusses use or spending restrictions. It is better practice for the charity to be proactive and create an endowment, by:

- Adopting an Investment Policy
- Adopting an amendable Spending Policy
- Creating an Endowment Fund, incorporating the Investment Policy and Spending Policies, for general or specific purposes
- Ensuring that solicitations and donor gift instruments reference and incorporate the Endowment Fund and its terms

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Colorado's version at Probate, Trusts and Fiduciaries Code section 15-1-1101:

15-1-1101. Short title. This part 11 shall be known and may be cited as the "Uniform Management of Institutional Funds Act" .

15-1-1104. Appropriation of appreciation. The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by section 15-1-1108. This section does not limit the authority of the governing board to expend funds as permitted under other law, the. terms of the applicable gift instrument, or the character of an institution.

15-1-1102. Uniformity of application and construction. This part 11 shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this part 11 among the states which enact it.

15-1-1106. Investment authority. (1) In addition to an investment otherwise authorized by law or by the applicable gift instrument and without restriction to investments a fiduciary is authorized to make, the governing board (subject to any specific limitations set forth in the applicable gift instrument or in applicable law other than law relating to investments a fiduciary is authorized to make) may:

(a) Invest and reinvest an institutional fund in any real or personal property deemed. advisable by the governing board, whether or not it produces a current return, including mortgages, stocks and bonds, and other securities of profit or nonprofit corporations, shares in or obligations of associations, partnerships, or individuals, and obligations of any government or subdivision or instrumentality thereof;
(b) Retain property contributed by a donor to an institutional fund for as long as the governing board deems advisable;
(c) Include all or any part of an institutional fund in any pooled or common fund maintained by the institution;
(d) Invest all or any part of an institutional fund in any other pooled or common fund available for investment, including shares or interests in regulated investment companies, mutual funds, common trust funds, investment partnerships, real estate investment trusts, or similar organizations in which funds are commingled and investment determinations are made by persons other than the governing board.

15-1-1108. Standard of conduct. In the administration of the powers to appropriate appreciation, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise ordinary care and prudence under the facts and circumstances prevailing at the time of the action or decision, and in so doing they shall consider long- and short-term needs of the institution in carrying out its educational,. religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions.

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