

THE COVID-19 OUTBREAK AND CHARITABLE ORGANIZATIONS IN NEW HAMPSHIRE

GUIDANCE REGARDING ENDOWMENT FUNDS¹

The Director of Charitable Trusts at the Attorney General’s Office has specific responsibility under New Hampshire law to oversee the administration of endowment funds and other assets held by charitable organizations.² The Charitable Trusts Unit often receives inquiries about whether charitable organizations may access their endowment funds as a potential source of emergency funding. These inquiries have increased recently since the COVID-19 outbreak has left many charities with revenue shortfalls, unexpected debt, and repayment obligations. This document is intended to provide charitable organizations with general guidance about endowments, New Hampshire laws that govern spending from endowment funds, and factors to consider before using an endowment for financial relief.³

What is an Endowment Fund?

The term “endowment fund” generally means a donor-restricted fund that is intended to be invested and used perpetually to sustain a charity and its mission. It is meant to grow so as to keep pace with inflation. Only a portion of the fund may be spent each year. An endowment fund can be created when a donor makes a gift with a written document that specifies that the gift is made for an “endowment” or that directs certain spending restrictions, using terms such as “income only.” The endowment can also be created when a donor makes a donation in response to a solicitation for support of an organization’s endowment fund. An endowment is not created by a donor’s mere recommendation that the funds be so used.

An “endowment fund” does not include funds that are board-restricted; that is, unrestricted funds set aside by a board of directors with the intent to invest them and refrain from using them for current spending. This is the case even if the board refers to the funds as “endowment.” Any spending restrictions on board-restricted funds can be modified by the board without either notification to the Charitable Trusts Unit or court approval.

What Spending Restrictions Apply to Endowment Funds?

In making an endowment gift, a donor may specify certain spending restrictions, such as “use no more than 4% of the average asset value each year.” When the donor has specified a clear spending restriction on a gift accepted by a charitable organization, the charity generally is obligated to comply with it. *See* RSA 292-B:4, I (“subject to the intent of a donor expressed in the gift instrument....”).

Where the donor does not specify such a clear restriction, but makes a more generalized restriction, such as to use “income only” or to “preserve the principal,” then spending from endowment funds of New Hampshire charitable organizations generally is governed by the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”), RSA 292-B.⁴ UPMIFA requires that a charitable

¹ Portions of this document were adapted with permission from the *Massachusetts Attorney General Guidance on Endowments for Charities Facing Financial Challenges Due to COVID-19*, dated April 28, 2020.

² RSA 7:19-32-1; RSA 292-B

³ This document is intended to serve as general guidance and is not intended to provide legal advice. Charitable organizations should consult with their own legal counsel before considering extraordinary spending from their endowment funds.

⁴ The charity also is required to comply with any use or purpose restrictions imposed by the donor at the time the gift was made and accepted.

organization manage its endowment fund in a way that preserves its purchasing power in perpetuity (or for the time the spending restriction is intended to last) and requires that it make spending decisions consistent “with the care an ordinarily prudent person in a like position would exercise under similar circumstances.”⁵ RSA 292-B:4, I. Importantly, in New Hampshire, the appropriation for expenditure in any year of an amount greater than 7 percent of the three-year-average fair market value of the endowment fund, creates a rebuttable presumption of imprudence.⁶ RSA 292-B:4, VI. Thus, while it may be possible under limited circumstances to rebut this presumption and spend more than 7 percent in a particular year, the board must develop a compelling record as to why the decision is not imprudent and document the reasons in the board minutes, as the board may need to answer to the Director of Charitable Trusts, particularly if the board fails to make downward adjustments in subsequent years. Consultation in advance with the Charitable Trusts Unit is highly recommended.

While UPMIFA is intended to preserve the purchasing power of a charity’s endowment, it does not absolutely prohibit spending from an “underwater” endowment; that is, an endowment with a current value less than the value of the initial and subsequent gifts. However, in making a decision to spend from an underwater endowment, the board of directors of the charity must act in good faith, meet the prudence standard set forth in RSA 292-B:4, and develop a plan for the endowment fund to recover in the future in order to preserve or restore its spending power.⁷

Can a Charity Borrow funds from its Endowment to Pay Operating Expenses?

The endowment fund is not a separate organization from the charity it supports, and “borrowing” from the endowment fund is more akin to an inter-fund transfer than a loan. The Director of Charitable Trusts therefore considers a “loan” from an endowment fund to be a spending appropriation, and it should be analyzed in accordance with the prudence standard set forth in UPMIFA. RSA 292-B:4. If the proposed “loan” would involve spending that cannot be justified as prudent under UPMIFA, the Director of Charitable Trusts takes the position that such an action requires prior court approval.

Can Endowment Funds Be Accessed Without First Seeking Court Approval?

There may be circumstances under which a charitable organization may access endowment and other funds to make ends meet without seeking court approval. For example:

- *Procedure in the Gift Instrument:* Though unlikely, the gift instrument (the document conveying the donation) could include a procedure that the charity may follow in order to release a spending restriction imposed by the donor.

⁵ UPMIFA requires consideration of the following factors in determining the prudence of an appropriation from an endowment fund: the duration and preservation of the endowment fund; the purposes of the institution and the endowment fund; general economic conditions; the possible effect of inflation or deflation; the expected total return from income and the appreciation of investments; other resources of the institution; and the investment policy of the institution. RSA 292-B:4, I.

⁶ This does not mean, however, that spending of 7% or less is considered to be “prudent.” A spending policy is prudent if based on a three year or longer rolling average calculation, prudent management of the portfolio, and the other factors set forth in RSA 292-B:4, I. In recent years, many larger charitable organizations have deemed a spending level of 4.5% to 5% to be the prudent amount, given current economic conditions.

⁷ UPMIFA requires that organizations with endowment funds with an aggregate value of less than \$2 million must notify the Director of Charitable Trusts at least 60 days prior to an appropriation for expenditure of an amount that would cause the value of the endowment funds to fall below the aggregate historic dollar value of the funds. RSA 292-B:4, V.

- *Board-restricted funds*: If the fund and the restrictions were actually established by the board of directors from unrestricted funds, the board of directors could modify the restrictions.
- *Donor consent*: The donors, if still living, could consent in writing to releasing the spending restrictions. RSA 292-B:6, I. Of course, the release or modification would not permit the fund to be used for a purpose other than that of the charity. *Id.*
- *Spending increase*: As discussed above, the board could increase endowment fund spending in one year with the potential for downward adjustments in later years. This can only occur if the board has met its fiduciary duty of care and the standards described in UPMIFA. The charity must still heed the 7% presumption of imprudence, preserve the long term purchasing power of the endowment, and respect the wishes of the donors. RSA 292-B:4. For endowment funds with a value less than \$2 million, there is a requirement of notice to the Director of Charitable Trusts under some circumstances. RSA 292-B:4, V.
- *Small, older funds*: Charities may seek the approval of the Director of Charitable Trusts to release or modify restrictions in funds with a market value of less than \$25,000 that were established more than 25 years ago. The proceeds must be used consistent with the purposes expressed in the gift instrument. RSA 292-B:6, IV.

What are some options for obtaining court approval for endowment spending?

If the board of the charitable organization determines that it is necessary to access additional endowment funds, it may explore modification proceedings in court. The board should consult with legal counsel for advice about potential remedies and their appropriateness. The following is general information about two options available under UPMIFA: relief under the doctrines of *cy pres* and deviation. Both doctrines recognize that with the passage of time and changed circumstances, a donor's original charitable intent—and the mechanisms for advancing that intent—may someday become obsolete.

- *Cy pres*: The *cy pres* doctrine permits a court to modify an endowment fund's charitable purpose or use restriction if it has become "unlawful, impracticable, impossible to achieve, or wasteful." RSA 292-B:6, III. *Cy pres* modifications must be consistent with the charitable purposes reflected in the original gift instrument. *Id.*
- *Deviation*: The doctrine of deviation permits a court to modify a management, investment, or durational restriction on an endowment fund if it has become "impracticable or wasteful, if it impairs the management or investment of the fund or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund." RSA 292-B:6, II. "To the extent practicable, any modification must be made in accordance with the donor's probable intention." *Id.*

Both the doctrines of *cy pres* and deviation require prior notification to the Director of Charitable Trusts, who has the right to be heard by the court. RSA 292-B:6. Thus, before a charity decides to seek relief under either doctrine, the organization should contact the Charitable Trusts Unit to discuss the proposed petition, the circumstances that led to the current financial situation, and the alternative steps the charity explored.

In deciding whether to assent or object to deviation or *cy pres* relief, the Director of Charitable Trusts will consider whether the board of directors of the charity explored other sources of funding before

looking to its endowment for financial relief. For example, did the charity examine whether it could raise new, unrestricted funds? Does the charity have board-restricted funds? Did the charity apply for funding available through federal or state sources?⁸

The Director of Charitable Trusts will also consider whether invading the endowment will materially increase the likelihood that the charity will continue operations in furtherance of its mission. If invasion will merely delay impending closure, cessation of operations, or discontinuance of charitable activities, modification of an endowment funds' spending restrictions may not be appropriate. Instead, the charitable organization should make a tough decision about its future. It may mean that the endowment will be preserved to advance the organization's mission, but through a different entity.

Conclusion

The COVID-19 pandemic has caused a devastating financial impact on many charitable organizations doing important work in our communities. Before exploring the possibility of invading endowment funds, however, boards of directors should consult with their legal counsel and carefully consider all other options available to satisfy their funding needs. After all, endowment funds are created to sustain the charity and further its mission long into the future. Invading the endowment to prop up current operations is inconsistent with an endowment's purpose and ignores donor intent.

Charities with questions about endowment spending may contact the Charitable Trusts Unit at 603-271-3591 or charitabletrusts2@doj.nh.gov.

⁸ Visit www.doj.nh.gov/charitable-trusts for a list of resources available to charities for emergency funding.