

CHARITABLE TRUSTS UNIT GUIDANCE REGARDING ENDOWMENT FUNDS¹

The Director of Charitable Trusts, who is responsible under New Hampshire law for overseeing the administration of endowment funds and other assets held by charitable organizations,² often receives inquiries about whether charitable organizations can access their endowment funds as a potential source of emergency funding. This document is intended to provide charitable organizations with general guidance about endowments, information about New Hampshire laws that govern spending from charitable endowment funds, and other factors to consider before they turn to endowment funds 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 to perpetually sustain a charity and its mission. It is intended to grow to keep pace with inflation, and 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 makes certain spending restrictions, such as “income only.” The endowment can also be created when a donor submits a donation in response to a solicitation to support an organization’s endowment fund. An endowment is not created by a donor’s mere recommendation that the funds be used for an endowment or by a request after the donation is made that it be included as part of the organization’s endowment.

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” funds. Any spending restrictions on board-restricted funds can be modified by the board without notification to the Attorney General or court approval.

What Spending Restrictions Apply to Endowment Funds?

In making an endowment gift, a donor may specify certain spending restrictions, such as “no more than 4% of the average asset value each year.” When the donor has specified a spending restriction on a gift accepted by the 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 restriction or makes a more generalized restriction, such as “income only” or “preserve the principal,” the 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 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

¹ Portions of this document were adapted or reprinted 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.

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 of 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 is made and accepted.

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 any amount greater than 7 percent of the fair market value of the endowment fund over a period of at least 3 years immediately preceding the expenditure, 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.

While UPMIFA is intended to preserve the purchasing power of a charity’s endowment, it does not contain an absolute prohibition against 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 would consider 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 it would require prior court approval.

Can Endowment Funds Be Accessed Without First Seeking Court Approval?

There may be circumstances under which endowment funds can be accessed to assist charities in paying their operating expenses or unexpected shortfall 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 could follow in order to release a spending restriction imposed by the donor.
- *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.

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.” Whether or not it is prudent is based on the three year rolling average calculation, prudent management of the portfolio, adherence to the standards in UPMIFA, and the factor set forth in RSA 292-B:4, I.

⁷ Note that UPMIFA requires that organizations with endowment funds with an aggregate value of less than \$2,000,000 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.

- *Donor consent*: The donors 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 the charity’s charitable purpose. *Id.*
- *Spending increase*: as discussed above, the board could increase the endowment fund spending with the potential for downward adjustments in later years subject to the board’s fiduciary duty of care and the standards set forth in UPMIFA, mindful that the charity must still preserve the purchasing power of its endowment and respect the wishes of the donors. RSA 292-B:4. The board must also comply with state law requirements regarding notice to the Director of Charitable Trusts. *See, e.g.,* RSA 292-B:4, V.
- *Relatively small, older funds*: charities may seek the approval of the Director of Charitable Trusts to release or modify restrictions in funds with a total value of less than \$25,000 that have been established more than 25 years, as long as the money will be used consistent with the purposes expressed in the gift instrument. RSA 292-B, IV.

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

If the board of the charity determines that accessing endowment funds is necessary, modification proceedings in probate or superior court may be available. The board should consult with legal counsel for legal advice about the potential legal remedies and whether they are appropriate. The following is general information about two options under UPMIFA: the doctrines of *cy pres* and deviation, both of which 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 the purpose or restriction 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 the restriction 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 Attorney General, 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 charity should contact the Director of Charitable Trusts to discuss the proposed petition and the factual and legal basis for the relief, including the circumstances that led to the current financial situation and the alternative steps the charity explored to address it.

Among other factors, one factor that the Director of Charitable Trusts will consider in deciding whether to assent or object to deviation or *cy pres* relief is whether the board of directors of the charity explored other sources of funding before looking to its endowment funds for financial relief. For example,

did the charity consider 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

Another factor that the Director of Charitable Trusts will consider is whether invading the endowment fund will materially increase the likelihood of the charity's continued 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.

Conclusion

Before exploring the possibility of invading their endowment funds, charities and their boards should consult with their legal counsel and carefully and thoughtfully consider all other options available to them to satisfy their funding needs. After all, endowment funds are created to sustain the charity and further its mission long into the future and invading the endowment to pay for operations is inconsistent with its purpose and donor intent.

Charities with questions about endowment spending may contact the Attorney General, 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.