

8 May 2020

Follow @Paul_Hastings



Charitable Organizations: Access to Endowments and Restricted Funds during the COVID-19 Crisis – A Practical Primer

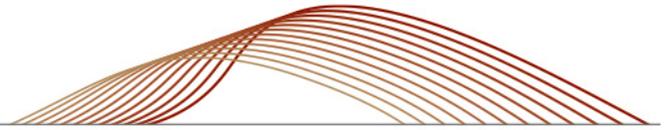
By [Charles Patrizia](#), [Quinn Dang](#), [Brendan Counihan](#), [Benjamin Stewart](#) & [Bill Belitsky](#)

Due to the financial strains arising from the COVID-19 pandemic, many non-profits are facing significant declines in donations and other sources of revenue. Some non-profits may wish to access endowments or restricted funds to address their current financial needs. This client alert sets forth key principles to guide non-profits in their management of endowments and restricted funds in order to confront the financial challenges posed by the COVID-19 crisis.

I. Endowment Funds

Endowment funds are typically established to provide a recurring income source to a charitable organization. These funds may generally be described as financial assets, typically held by a non-profit, which contain the original assets (the “corpus”) and related earnings generated by the corpus over time. Most endowment funds are designed to keep the principal corpus intact; withdrawing money from the corpus is referred to as “invading the corpus,” which is often prohibited by the endowment fund’s governing documents and/or by the gift instruments from donors. Instead, the goal of most institutions having endowment funds is to allow the corpus to grow without withdrawals so that the corpus increases in value over time, with the interest earned being available each year to support the ongoing fund of the non-profit’s operations, programs, and stated purposes of the endowment fund.

Although institutions having endowment funds are usually able to finance their operations from donations, other revenues and the income earned from their endowment funds during normal economic times, institutions often struggle to meet their financial obligations during periods of financial distress such as the one they may be currently facing. In order to avoid withdrawals from the corpus at a time when fundraising is especially challenging and value declines in endowment funds may be substantial, many institutions resort to cutting expenditures, borrowing, or even merging with other institutions. While the above measures may be suitable for some institutions, others may prefer to spend down a portion of their endowment fund corpus immediately in order to sustain expenditures and current obligations, especially if their services are in heightened demand. While the restrictions noted above may prevent institutions from using their endowment fund corpus as a source for expenditures, there exists statutory authority for institutions to chart such a path.



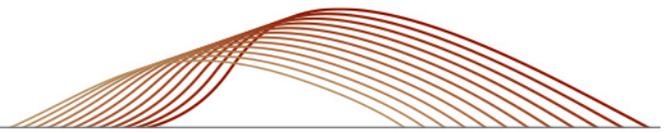
The Uniform Prudent Management of Institutional Funds Act (“UPMIFA”), which has been adopted by the District of Columbia and all states except Pennsylvania, provides guidance on the management of funds, including endowment funds, held by non-profit institutions. Section 4(a) of UPMIFA provides that “an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes and duration for which the endowment fund is established.” In making a determination to appropriate for expenditure or accumulate, the institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, the following factors:

1. the duration and preservation of the endowment fund;
2. the purposes of the institution and the endowment fund;
3. general economic conditions;
4. the possible effect of inflation or deflation;
5. the expected total return from income and the appreciation of investments;
6. other resources of the institution; and
7. the investment policy of the institution.

Therefore, Section 4 of UPMIFA permits expenditures from an endowment fund to the extent the institution determines that such expenditures are prudent after considering the factors listed above. In some years, accumulation rather than spending will be prudent, but during a crisis like COVID-19, an institution may appropriately make expenditures even if a fund has not generated investment return that year.

We emphasize that non-profits must honor any restrictions expressly imposed by donors on the uses and expenditure of donated assets. Section 4(b) of UPMIFA generally provides that a gift instrument must specifically state the limitation if the donee institution is to be limited in its authority to appropriate for expenditure or accumulate. Therefore, absent such an express written limitation, a non-profit generally has the option to draw funding from an endowment fund’s corpus. Where the non-profit’s board has chosen to move some donated funds into an endowment, where the donor did not express that intention or limitation, those funds are subject in any event to the board’s proper discretion.

Although the above provisions grant institutions authority to make appropriate expenditures from their endowment funds, non-profits should document the board’s consideration, and establish policies to justify the expenditure of more than seven percent of the endowment’s value in one year. Section 4(d) of UPMIFA creates a “rebuttable presumption of imprudence” for the “appropriation for expenditure in any year of an amount *greater than seven percent* of fair market value of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of not less than three years immediately preceding the year in which the appropriation for expenditure is made.” With respect to this subsection, please note that (i) it does not apply to an appropriation for expenditure permitted under law other than UPMIFA or by the gift instrument, and (ii) the subsection is bracketed, meaning that the UPMIFA drafting committee did not arrive at a



consensus on its advisability and therefore decided to leave it to legislatures as an option. Therefore, this rebuttable presumption of imprudence may not have been adopted by some or all jurisdictions.

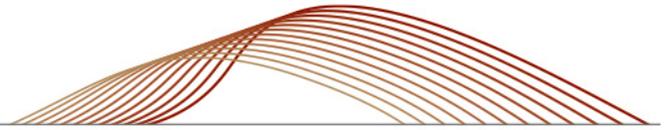
Whether or not a statute includes the above presumption, institutions must consider the intent of their donors as expressed in their gift instruments and the factors listed above in making expenditure decisions. For institutions that wish to sustain program spending by making expenditures from their endowment funds during these challenging economic times, the good news is that UPMIFA may grant them such statutory authority. Finally, as noted above, it is important to understand that UPMIFA is a model statute and the applicable version of UPMIFA varies from state to state, and therefore an individualized assessment if required for each non-profit to determine how UPMIFA applies to proposed expenditures and actions.

II. Restricted Funds

Donor restricted funds¹ are subject to donor restrictions on use or spending, such as requiring the funds to be used for specific research or limiting spending to only investment income derived from donor restricted funds. The donor typically states any fund restrictions in the grant agreement, gift instrument, or other document evidencing the donation. The restrictions are legally binding on the non-profit provided that they are stated as requirements, and not mere recommendations, and are stated either prior to or coincidentally with the contribution. Generally, both a donor and a state's attorney general ("AG") have standing to enforce restrictions on funds donated to non-profits.

Despite the challenges posed by the COVID-19 pandemic, donor restrictions on funds remain legally binding for non-profit recipients. But there are several options for the non-profit to legally modify or release restrictions:

- *Donor Consent:* The most straightforward option for modifying or releasing restrictions on funds is to obtain written permission from the donor. This generally requires the original donor to (i) be alive if an individual or (ii) still be in existence if an entity. Sometimes the document evidencing the donation may grant to another person or entity the necessary authority to lift restrictions in which case such permission may be obtained from that person or entity as needed.
- *Variance Power Clauses:* Certain non-profits such as community foundations often include a variance power clause in their form donation document provided to donors. The variance power clause allows the non-profit to use funds for a purpose that is outside of the scope of the donor's restrictions, usually due to changed circumstances that make the restriction unnecessary or impracticable.
- *Notice to the AG under UPMIFA:* UPMIFA allows a non-profit to modify or release donor restrictions without the donor's consent by giving prior written notice to the AG if:
 - the restriction is impossible to achieve, illegal, impracticable, or wasteful;
 - the restricted fund has a value below a certain dollar amount, depending on the state;
 - the restricted fund is more than 20 years old; and
 - the non-profit uses the fund in a manner consistent with the donor's charitable intent expressed in the donation document.



The funds must still be used in a manner consistent with the donor's general purpose, and the non-profit generally needs to provide notice to the AG, typically 60 to 90 days before using the restricted funds. The non-profit must look into the specific requirements of its state's version of UPMIFA before pursuing this option.

- *Court Petition:* Non-profits may also petition courts to modify or release the donor restrictions on funds. The court will require the non-profit to show that compliance with the funds' restrictions has become impossible, illegal, impracticable, or wasteful. The donor must also consent to the change in restrictions if still alive or in existence, and UPMIFA requires prior notice to the AG of such court proceedings. Due to the length and expense of the court process, this option may not be useful for non-profits in need of more immediate access to restricted funds.

While this client alert sets forth general legal guidelines, we recommend that readers seek specific advice from counsel about particular matters of interest. Paul Hastings attorneys are available to help advise our non-profit clients regarding the management of endowments and restricted funds.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

New York

Bill Belitsky
1.212.318.6097
billbelitsky@paulhastings.com

Brendan Counihan
1.212.318.6075
brendancounihan@paulhastings.com

Palo Alto

Ben Stewart
1.650.320.1898
benjamins Stewart@paulhastings.com

Washington, D.C.

Charles Patrizia
1.202.551.1710
charlespatrizia@paulhastings.com

Quinn Dang
1.202.551.1891
quinndang@paulhastings.com

¹ The non-profit's board may impose restrictions on certain funds or certain assets. Those are "board restricted" funds, and always remain subject to the board's discretion, and are distinct from "donor restricted" assets. We emphasize that the non-profit's board should carefully review the history of fund flows into the endowment to distinguish between amounts that were donor-restricted, board-restricted or otherwise unrestricted. Clear documentation is essential (however, UPMIFA recognizes that older contributions may not have documentation and one can look to surrounding circumstances).

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2020 Paul Hastings LLP.