



JBWere

## Endowments for non-profit organisations

### What is an endowment?

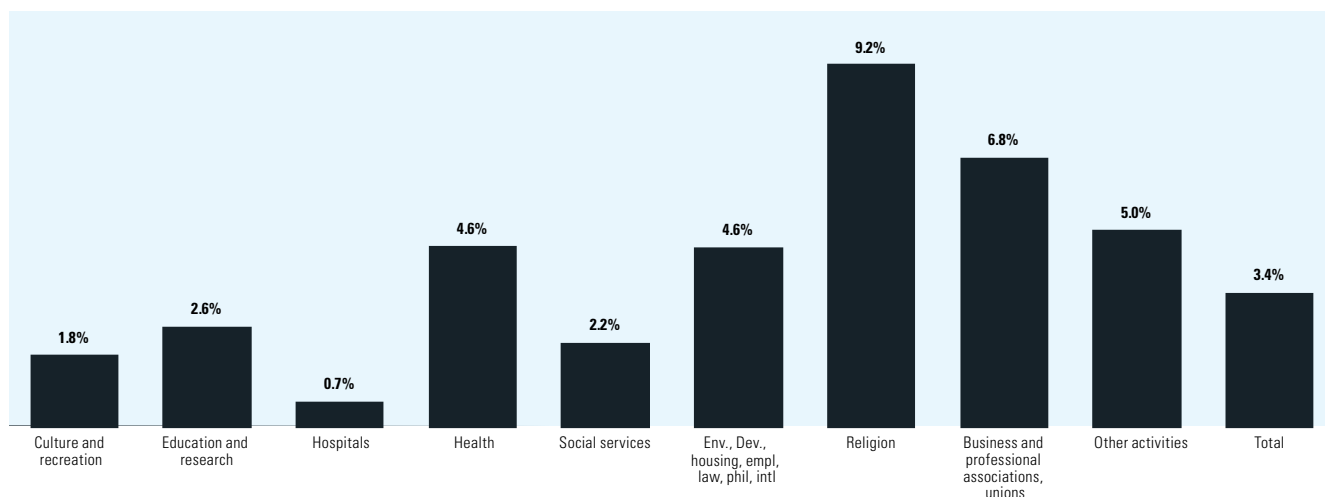
An endowment is a sum of money that you invest, allowing the principal to grow whilst using a portion of the investment return to meet ongoing income requirements. An endowment may also be known as a capital reserve, capital fund, corpus, investment portfolio and more. Endowments are usually considered long-term strategies which enable non-profit organisations to develop internally generated income streams. In most cases, both principal and investment returns are controlled by the board or trustees of the organisation. An endowment is typically made up of donations and bequests from donors as well as

public and private sector grants. Contributions can be one-off, ad hoc, or periodic.

Endowments are becoming more popular among non-profit organisations as they look to develop sustainable income streams that reduce their reliance on third party funding. Non-profits are particularly drawn to the idea of an endowment as an ongoing source of untied funding that can be used to smooth operational funding in good and not so good times, and to help meet expenses that third party funders are often reluctant to support, such as administrative costs, and new, untested programs.

A demonstration of the reliance on investment income for the various non-profit causes can be found below. There is an increasing trend towards reliance on invested income, as non-profits look to become more self-reliant.

## Investment Income % of Total Income



Source: ABS 2007

## Why have an endowment?

The purpose of most endowments is to generate a permanent, steady stream of income. By using an endowment, a non-profit organisation is able to diversify its sources of income and complement regular fundraising efforts with passive income earned from invested funds. Endowments are often used for funding expenses which are considered hardest to raise money for, such as general operating expenses, maintenance costs and deficit funding.

Endowments provide an income stream that is not reliant on third party support. This promotes the sustainability and longevity of a non-profit organisation. Investment income can be utilised by a non-profit organisation to support the day-to-day operations of the organisation or a specific program. Alternatively some non-profit organisations choose not to use income habitually, instead choosing to draw on it as 'rainy day' funding, when times are difficult, when an unexpected expense requires funding, or when a new opportunity presents itself to the organisation.

Additionally, well-managed endowments have the capacity to attract donations, as they demonstrate an organisation's ability to achieve its social mission and deliver sustainable long-term social outcomes, ensuring that a donor's philanthropic dollar is also well-managed and maximised.

Endowments can provide greater flexibility and support for non-profit organisations and the programs they run. Non-profit organisations should therefore be encouraged to investigate if building an endowment may be appropriate in their circumstances and what steps might be needed to establish an endowment.

## Characteristics of endowments:

- Part of the investment returns generated by an endowment may be reinvested to help maintain the 'real' value of the principal and potentially create a growing income stream.
- An endowment usually operates in a tax-exempt environment and benefits from franking credit rebates, greatly increasing the probability of generating 'real' returns above inflation.
- All endowments should develop and maintain an investment policy, that governs the manner in which funds are managed and invested and ensures that the financial outcomes are aligned with the non-profit organisation's own mission and goals.
- The use of asset allocation as a fundamental means of diversification can significantly reduce risk, without considerably reducing returns. Adequate diversification can mitigate the effect of holding some investments in poorly performing asset classes for a period of time, whilst still allowing for long-term growth in 'real' terms.

## When should a non-profit organisation create an endowment?

A significant capital sum helps an endowment make a meaningful impact on the financial situation of a non-profit organisation. For example, in order to generate an annual income stream of \$25,000 from an endowment, an organisation would need to commit a sum of approximately \$500,000 (at 5% income return). Whilst this may be a significant commitment, an endowment can go a long way to ensuring the sustainability of a non-profit organisation and can help that organisation achieve its mission and goals. Additionally, it is possible to build up an endowment over time through investments providing capital appreciation in a tax-exempt environment and additional contributions.

Events such as receipt of untied funding, sale of an asset, significant liquidity events, bequests or, if properly explained to supporters, a significant donation or a successful capital raising campaign are often the trigger points for establishing an endowment.

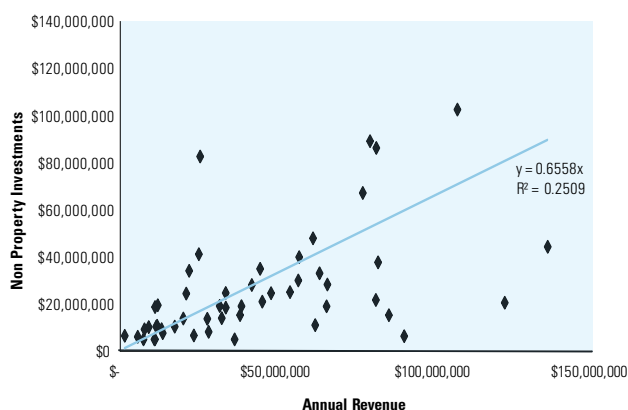
## Some tips on building an up an endowment, include:

- Moving budget surpluses each year into the endowment.
- Establishing and following a policy that all windfall donations and unrestricted bequests go into the endowment and not into the operating budget.
- Establishing and following a policy that a percentage of all fundraising initiatives be allocated to the endowment.
- Informing key funders about the endowment. They must be educated about the need for larger gifts to help ensure an organisation's future. Take every opportunity to educate funders with articles and stories about gifts to the endowment and its role in helping the organisation achieve its mission and goals. Most funders will perceive the establishment of an endowment to be a sign of good planning and long-range thinking on the part of the non-profit organisation. Let the endowment become your funders' way of providing ongoing support from their one off donation.
- Minimising the application of endowment income in early years in order to build a sustainable corpus.

## Non-profit organisations' current commitment to endowments

The chart below demonstrates that non-property investments average around 66% of annual revenue for all non-profit organisations.

Source: Givewell, 2008



With simple initiatives such as those mentioned above and discipline, a non-profit organisation has the potential to quickly accumulate an endowment that will serve the organisation for years to come.

## First steps to establishing an endowment:

1. Understand the financial requirements to achieve an organisation's mission.
2. Work with an experienced financial adviser who understands the sector and the individual organisation. Understand where costs come from and incorporate these into a financial model. Incorporating the liquidity consideration for the endowment (to fund programs etc.) and including expected cash flows into investment decisions are of considerable importance to successful investment management.
3. Understand the long-term operational time frame.

4. Fully utilise a non-profit organisation's Tax Concession Charity status and ability to gain a refund of imputation (franking) credits within a balanced asset allocation.
5. Understand the relationship between risk and reward.
6. Formulate investment objectives and policies to reach these goals.
7. Determine an appropriate asset allocation and identify any particular ethical considerations, which may be important in maintaining consistency between your mission and your investments.
8. Match the time and effort of each investment policy decision with its importance and impact. Many spend far more time on stock or manager selection than on asset allocation, which is consistent with their likely impact on portfolio performance.
9. Most importantly, have all stakeholders working to the same goal, delivering on the organisation's mission. Once this is achieved, the risks of 'not on my watch' syndrome, of misplaced conservatism and false economy will be replaced by a vision that maximises an organisation's total social impact over the long term.

## An investment policy

The foundation of most successful investment management programs is a comprehensive investment policy. A well-formulated investment policy for a non-profit organisation can act as both a blueprint and a scorecard for managing its investment strategy. An investment policy is a key tool for all investors and even more critical for boards, trustees or other investment fiduciaries who are entrusted to oversee the investments of non-profit organisations. The investment policy forces these entities to put their investment strategy in writing and commit to a disciplined and systematic approach. It is designed to take the emotion out of investing and keep strategies on track, regardless of how the markets or the economy behaves. A well thought out investment policy will align the investment parameters of an endowment to the mission of the non-profit organisation and help prevent knee-jerk reactions in times of financial market extremes.

The ability of an endowment to maintain or grow the real value of its principal over time, whilst simultaneously generating an income stream, is largely dependant on the investment strategy adopted. There will be times where endowments outperform expectations and other times when they shrink in value and fail to generate sufficient income. Such circumstances should be considered and the desired investment reactions incorporated into an investment policy.

The JBWere Philanthropic Services team complements the investment advisory services of JBWere, by offering endowments, foundations and non-profit organisations access to the team and its research. The team has significant experience in issues relating to:

- long-range planning, sustainable spending policies and asset allocation;
- current "best practices" across the country in the non-profit sector;
- understanding the needs and management requirements of endowments, foundations and non-profit organisations; and
- donor relations, fundraising and grant-making

The JBWere Philanthropic Services team is committed to contributing to the ongoing development of the philanthropic and the non-profit sectors in Australia and New Zealand. Our team has been an integral component of JBWere's wealth management offering since 2001.

We work with individuals, families and businesses to help them develop and implement strategic philanthropy goals that meet their particular family, legacy, tax or financial situation.

We also work with non-profit clients on governance, on how to maximise investment outcomes and on how to appeal to donors. In further support of our clients, we conduct and compile research on best practice in the non-profit space and share these findings with our clients. Additionally, our team provides capacity-building seminars and events that provide educational opportunities for non-profit staff and board members.

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To find out more about how our JBWere Philanthropic Services team can help you, please contact:

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